# The (dis)advantages of being a *US Person* (residing outside the US)

By David C. Camerini and Tomás M. Casalins

Fox Horan & Camerini LLP

For many years now, there has existed a notion that possessing what is referred to as a "second citizenship" or "second nationality" is a very valuable asset. In Latin America, a good amount of people possess a "second citizenship" from a European country; others also have United States citizenship.

The majority of these people, who are "dual citizens" or "dual nationals," were born in the country of their "first citizenship," where they reside permanently (and later obtained the "second citizenship"). There are also those individuals who were born in the country where their parents were studying or working temporarily, and when they were born, they adopted that country's citizenship (as their "first citizenship"). These individuals lived for very little time in the countries where they were born, and when their parents finished their studies or work in those countries, they moved with their parents to the country of their parents' citizenship, then adopting that ("second") citizenship.

For example, it is a common occurrence that young couples, who travel to the US to study and/or work, decide to return to their home country after a few years of residing in the US. A decent amount of these young couples have children while in the US. Although these children, generally, at some point adopt the citizenship of their parents, with a few exceptions, they are US citizens for all intents and purposes solely because they were born in the US. These children are commonly known as US citizens "by accident" (or "accidental *gringos*").

This is not an atypical situation, and it is a situation generally viewed as very favorable that provides "options" for these children, such as the ability to study or work

in the US and utilize a passport that allows for travelling to several countries without the need of a visa. However, when these "options" are weighed, the analysis of the tax consequences of possessing this US citizenship is frequently not done.

The US citizens and tax residents (legally defined in the US as "US Persons") who are residing outside the US have the same tax obligations as those US Persons residing within the US. The US is one of the few countries that taxes its citizens and tax residents without taking into consideration the country in which they reside. Other countries only tax the persons who reside within it.

The tax obligations of US Persons are numerous and practically impossible to list. The situation of each taxpayer must be analyzed individually. The penalties and fines for the lack of compliance with tax obligations are very severe, including those that are criminal. In summary, US Persons are required to file tax returns annually in the US for their world-wide income; in other words, for all the income they have received within and without the US.

In addition, US Persons are required to file numerous "report forms." What are report forms? Report forms are forms that are required from each taxpayer to report to the fiscal and regulatory authorities certain factual situations, such as whether the taxpayer owned a certain amount of shares or serves as a director of a foreign entity, or if they received a gift or a distribution above a certain value from a foreign person. Generally, these forms do not require by themselves the obligation to pay taxes. It is, however, possible that these forms indirectly indicate that the taxpayer is the owner or controls assets that received income which may be taxable in the US.

Among the most renowned report forms of recent years is the "famous" Report of Foreign Bank and Financial Accounts ("FBAR"). In summary, the FBAR is a form that must be filed annually by all US Persons who have (i) a financial interest in (either owned directly or indirectly through other entities controlled by them), (ii) signature authority over, or (iii) other authority over any foreign bank or financial accounts if the

aggregate value of such accounts exceeds $10,000 at any time during the calendar year, regardless of whether the accounts have been closed during that year.

By now, the changes experienced globally in recent years past are not new and are not unknown, particularly related to the economic crisis experienced by the US at the end of 2008. As a consequence of this crisis, the US pushed forward certain initiatives with the intent to curb and halt fiscal evasion and money laundering, among other purposes. For example, as the result of one of these initiatives, US Persons have been contacted by several foreign banks where they maintain bank or financial accounts, informing them that in order for the bank to comply with certain legislation (in particular with the Foreign Account Tax Compliance Act – "FATCA"), the bank was required to report to the authorities the name of all their clients who were deemed US Persons. In other cases, certain individuals encountered difficulties in attempting to renew their US passports at the US consulates in their home countries for not being tax compliant in the US.

Because of these and other circumstances, many individuals recently started to inquire about the tax obligations they have as a US Person. More than a few individuals were surprised to learn about the amount of tax and reporting obligations in which they were not compliant.

Regardless of such, as a whole, US legislation reflects a clear idea about the situation that is described here about "dual citizens" (and about the US Persons who reside permanently outside the US), and it offers certain alternatives which allow avoiding disproportionate consequences.

For example, in the US there exists what is known as the "*Foreign Earned Income Exclusion Standard Deduction*." So although US Persons are required to file tax returns annually in the US based on their world-wide income, those who are residing permanently outside the US may qualify to exclude from their taxable income a certain amount of it. In general terms, this income that may be excluded are salaries and income received outside of the US related to employment status, commonly known as "earned

income." The "earned income" does not include dividends, interests, or capital gains. The amount that may be excluded of the taxable income varies annually. For the fiscal year of 2015, the amount is $100,800. In order to claim this deduction, it is required to file US federal income tax returns annually.

In reference to income from dividends, interests, and capital gains, US Persons may take a "credit" on the income tax that would have been paid outside the US in relation to such income, on account of a certain percentage of the income tax which eventually is owed in the US. However, this "credit" will not apply automatically and each situation must be analyzed individually.

In addition, there are certain programs designed to "regularize" the tax situation of US Persons who may require it. For instance, in reference to the above-mentioned FBAR, today there are two programs available. One is referred to as the "Streamlined Procedure" and the other is the "Offshore Voluntary Disclosure Program" ("OVDP").

The Streamlined Procedure is available for those US Persons who are in a position to certify under perjury that the lack of compliance with their tax and reporting obligations was not willful. In other words, the lack of compliance is based on their ignorance of the applicable regulations. The OVDP is for those US Persons who are in no position to do such a certification. The structure of each of program varies and, in certain cases, is extensive. For purposes of this article, it is notable to mention that the Streamlined Procedure is a less burdensome program with lesser fines and penalties than the OVDP. Nonetheless, both programs offer considerable advantages to "regularize" a taxpayer situation.

Aside from these programs, the tax authorities may also consider exceptional cases in order to reduce fines and penalties for the lack of compliance or the delay to file tax returns. For such purposes, the taxpayer must be in a position to demonstrate "reasonable cause." The concept of "reasonable cause" is broad and there are only a few cases that succeed in establishing it.

In certain circumstances, some of these “dual citizens” consider renouncing the citizenship of the country where they do not reside. In the US when someone initiates the process to renounce their citizenship, he or she faces difficulties in fulfilling with one of the most important requirements to do so. This requirement entails that the taxpayer is in a position to state that he or she is tax compliant in the US (including the reporting obligations).

Those who believed that dual citizenship was without doubt a great advantage possibly today have second thoughts. A first lesson in order to avoid a burdensome situation is to seek the appropriate advice and start from an early age to comply with the tax obligations of every jurisdiction from which an individual is a citizen or resident. With adequate planning, the negative tax consequences may be minimized and may allow for taking advantage of the benefits that a “second citizenship” can provide.