

Oops ... Did I “Expatriate” and Never Know It: Lawful Permanent Residents Beware!

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Expatriation” from the United States is often very controversial in the context of U.S. citizens who formally renounce citizenship. There is probably no other U.S. international tax topic for individuals that can strike greater personal emotions than leaving the United States. To some, it sounds like abandoning the country. Americans do not have a history or tradition of leaving the United States to make their careers, families and fortunes abroad, unlike the Dutch, Mexicans, British, Spanish, Indians and many others from countries around the world.

To the contrary, the United States is traditionally a country of immigrants;¹ a young country where people have generally wished to immigrate into and not out of the United States.

This article does not address U.S. citizens who renounce their citizenship. Instead, it focuses on how many “lawful permanent residents” (LPRs)² may have inadvertently expatriated for U.S. federal tax purposes. The article first describes key tax definitions applicable to LPRs, the formal process under the immigration laws of terminating LPR status and then ultimately explains various tax consequences of expatriation (whether inadvertent or not).

A brief look at patterns of (i) immigration (with an “i”) and (ii) emigration (with an “e”—as in the case of expatriation) within the United States over the last couple of decades is revealing. These trends reflect that the United States has traditionally been a country of immigrants who come to the United States and not of emigrants who leave for greater opportunities.³

Importantly, the number of LPRs is in the millions. The Office of Immigration Statistics estimated that 12.5 million LPRs lived in the United States on January 1, 2009, and 7.9 million of those LPRs were eligible to naturalize.⁴ These estimates do not attempt to identify LPRs who are living predominantly outside the United States, which is the focus of this article; *i.e.*, the possible “inadvertent expatriate!”

1. Who is a LPR?

The definition of who has “lawful permanent residency” for U.S. income tax purposes is based, in large part (but not exclusively), upon U.S. immigration law. The Immigration and Nationality Act (the “Act” or INA) defines permanent resident status as being lawfully accorded the privilege of permanently residing in the United States as an immigrant.⁵ Furthermore, *for immigration law purposes*, this lawful permanent residency status requires that the person physically resides in the territory of the United States in a permanent form.⁶ Although a person may have multiple residences, residence in the United States must be a permanent one.

If a lawful permanent resident permanently leaves the United States and takes up permanent residency in their home country, or any other country outside of the United States, he or she will apparently no longer have the lawful privilege (for immigration law purposes) of returning and residing permanently in the United States.⁷ Nevertheless, Reg. §301.7701(b)-1(b) provides that these individuals retain their U.S. person status (as a “resident alien”) *for U.S. income tax purposes*. Under the existing regulatory rules, these individuals continue to be taxed on their worldwide income, but for the application of an income tax treaty, discussed further in this article.

When Congress enacted Code Sec. 7701(b), it recognized that an individual who would be treated as a resident alien under Code Sec. 7701(b)(1)(A) might be treated as a nonresident alien under the so-called “tie-breaker” rules of the income tax treaties to which the United States is a party.⁸

These rules present a confusing mix, when the 2008 amendments were adopted adding Code Sec. 7701(b)(6) which provides in relevant part as follows:

An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.

The focus of this article is exactly on how this provision can create the inadvertent “expatriation” for U.S. tax purposes. This article does not attempt to explain in great detail the mark to market income tax consequences and gift or inheritance tax consequences caused by a so-called “covered expatriate.”⁹

Each individual who has a green card in his pocket, but who lives predominantly outside the United States, should carefully analyze how the above tax rules can affect his on-going U.S. tax liability and his immigration status.

2. Overview of Worldwide Taxation—U.S. Citizens and LPRs

U.S. citizens are taxed on their worldwide income, regardless of where they might physically live.¹⁰ This system of worldwide taxation of income, plus estate and gift tax transfers,¹¹ based only upon citizenship and regardless of source, seems odd to most individuals and tax advisors in other countries, since virtually all other countries of the world impose income taxation on worldwide income only if the individual is physically resident in a particular country (*e.g.*, for a sufficient number of days).¹²

U.S. taxation of citizens has a long history going back to 1861 and the Civil War.¹³ The concept of citizenship-based taxation was upheld by the U.S. Supreme Court in the 1920s.¹⁴ See *Cook v. Tait*,¹⁵ where a U.S. citizen resided permanently and was domiciled in Mexico City with his Mexican-citizen wife, and the Court found that U.S. taxation of his Mexican source income was indeed constitutional.

Importantly, LPRs are similarly taxed for income tax purposes like U.S. citizens, irrespective of where

they may reside, with one important exception created by Code Sec. 7701(b)(6), which is the focus of this article.

One appeals court has acknowledged the principle of worldwide taxation as it applies to LPR noncitizens residing in the United States: “In the case of our own citizens domiciled elsewhere, we exact income taxes upon their entire income, from whatever source derived [citing *Cook v. Tait*]While this legislation is severe, and as a matter of economic policy may not be sound, it is hard to see why aliens who have acquired a fixed abode here should fare better.”¹⁶

3. “Losing the Green Card and Knowing It?”— The Immigration Law

There are a variety of ways in which a green card can be revoked under the U.S. immigration laws, as follows:

- renunciation,
- abandonment, (either willingly or unwillingly, by judicial order),
- removal,
- reversion, and
- rescission of adjustment.

There are three ways to willingly renounce lawful permanent resident status, effectively revoking the green card. In the case of an affirmative renunciation, it is not the statement renouncing residence, but the absence of a fixed intent to return, that results in the loss of LPR status.¹⁷ First is the submission of INS Form I-407 to a U.S. Embassy or Consulate Office outside of the United States. Second, an individual who wishes to terminate his or her permanent residency may simply mail his or her green card back to the Department of Homeland Security. Third, a green card holder may permanently leave the United States without relinquishing his or her green card although, in this case, such individual would continue to be taxed as a U.S. resident.

In all cases involving loss of lawful permanent resident status, the burden of proof is on the government to prove the loss by clear, convincing and unequivocal evidence. Lawful permanent residence is not lost until there has been a final administrative order of removal, except in the case of rescission.¹⁸

Abandonment of permanent residence is always a question of intent. Since the green card is based on physical presence within the United States, an

individual who is absent from the United States for over a year is presumed to have intended to abandon permanent residence and may have their green card revoked by a judicial order. Although the presumption of abandonment applies to an absence of over one year, a person can be found to have abandoned their status after just several months or to have retained their status after an absence of long over a year. The determination hinges upon the length, purpose and overall temporary nature of the trip outside the United States.

An individual may be required to involuntarily relinquish the green card if they are deported from the United States in removal proceedings based on deportability or inadmissibility (through a judicial or administrative proceeding). LPR status under the immigration laws ends with the entry of a final administrative order of deportation, removal or exclusion. Intent in such cases is not the issue as the loss of status occurs by operation of law.¹⁹ Proceedings can be brought at any time, so long as the person has not become a naturalized U.S. citizen.

Reversion is the process whereby a lawful permanent resident can be adjusted to the status of a nonimmigrant to A, E or G status, thus terminating their legal permanent resident status by operation of law under specific circumstances. Reversion can be prevented by executing a waiver of all the rights and benefits of the nonimmigrant status. If the alien fails to take action, the Department of Homeland Security is without discretion and must effect a reversion.²⁰

Finally, a green card holder may be forced to relinquish permanent residency through rescission of adjustment. This special procedure can be sought by the government within five years of the adjustment of status if the person was not eligible for the status at the time it was obtained.

a. Procedural Steps for Renouncing U.S. Lawful Permanent Residence (Green Card)

Renunciation of legal permanent resident status can only be determined by the Department of Homeland Security. Consular officers are not authorized to make such determinations.²¹ However, they may assist an alien who willingly surrenders the Form I-551, Permanent Resident Card (green card), by asking the alien to complete Form I-407, Abandonment of Lawful Permanent Resident Status, accepting the card and returning it, with the completed and signed

Form I-407, to the USCIS Texas Service Center.²² USCIS will then transmit the Form I-407 to the relevant district office for review and inclusion in the alien’s immigration file.²³

Form I-407 is used by consular officers to record the facts relating to aliens interviewed in person and may also be used by immigration officers to record the facts relating to aliens who abandoned status by correspondence (mailing the green card back to USCIS) or as an acknowledgement from a third person or agency. According to the instructions on Form I-407, it is “designed to provide a simple procedure to record the abandonment of residence of a lawful permanent resident alien of the United States,” and “to assure that the alien is accorded due process of law and has voluntarily, willingly and affirmatively abandoned lawful permanent resident status.”²⁴ The form includes the following language as a statement of renunciation: “I voluntarily, willingly and affirmatively am abandoning/have abandoned my status as a lawful permanent resident of the United States because:” (the individual indicates their reasoning here).

This form also assures that the person relinquishing his or her permanent residence is informed of his right to a hearing and has intelligently waived that right (in cases involving applicants for admission) or is aware of his right to a hearing in the future. The form includes the following language: “If you waive your right to a hearing now, you can have a hearing at any time hereafter before an Immigration Judge to determine your admissibility by presenting yourself at a port of entry to the United States and seeking entry. If you do seek a later hearing, the Immigration Judge can and will take into account all statements you have made concerning your abandonment of residence in the United States.”

b. Why the Procedural Steps for Renouncing U.S. LPR Is of Little Consequence for the “Tax Non-LPR”

The above provides an explanation of how an individual can formally renounce their legal permanent resident status under the immigration laws of the United States. Obviously, anyone who takes these steps will know they will have ceased to be a LPR. This article focuses on those LPRs who do not take any of the above steps but for U.S. tax purposes cease to be a LPR due to Code Sec. 7701(b)(6). This category of LPR is referred to in this article as the “Tax Non-LPR.” In other words, the individual continues to have

their “green card” in their pocket, no renunciation of it was undertaken; yet for federal tax purposes, they cease to be a LPR.

4. Inadvertent Expatriation?—Emigration

Now, the plain language of Code Sec. 7701(b)(6) will be revisited, which provides in relevant part as follows [emphasis added]:

An individual ***shall cease to be treated as a lawful permanent resident*** of the United States if such individual ***commences to be treated as a resident of a foreign country under the provisions of a tax treaty*** between the United States and the foreign country, ***does not waive the benefits of such treaty*** applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.

Many questions are raised by this language in this 2008 amendment.²⁵

What are all the requirements for the LPR to cease to be treated as a LPR for tax purposes? Apparently, the plain reading of the statute includes: (1) an income tax treaty application where the “tie breaker” rules determine he or she is a resident of the other country—the treaty country and not the United States; (2) where no waiver of the treaty is made; and (3) the LPR notifies the Secretary of such treatment under a treaty. How does a taxpayer comply with this requirement? The regulations are very clear about the procedure for these so-called dual resident taxpayers.²⁶ In the case of a “dual resident” under a tax treaty, who is a resident of a foreign country under an applicable tax treaty, he should file a nonresident income tax return (IRS Form 1040NR) and attach Form 8833.²⁷ The IRS, under the prior statutory language, has taken the position that a dual resident may be treated as a U.S. resident only if she (i) does not claim treaty benefits to be treated as a nonresident and (ii) files U.S. tax returns as a U.S. resident and pays tax on her worldwide income.²⁸

These rules raise yet further questions. What if no IRS Form 8833 is filed or not filed timely for the period when the return was due? When is the exact date the LPR ceases to be a LPR for tax purposes? Code Sec. 877A(g)(3)(B) provides that the LPR residency is terminated on the “expatriation date,” which is a circular definition, since the

“expatriation date” is defined with reference back to Code Sec. 7701(b)(6).

What if a taxpayer files IRS Form 8833 in the year 2013 with reference to a prior tax year, such as the year 2005? Does the expatriation date relate back to the year 2005?

The answers to these questions are obviously of great importance, since the LPR may not be a “covered expatriate” if he or she was not a LPR for a long enough period (eight of 15 years) to be a “long-term resident of the United States.” Of course, if the required time periods are satisfied such that the LPR is a covered expatriate, the LPR could have significant U.S. income tax liabilities to pay due to the “mark to market” tax upon expatriation.

A simple example should shed light on the application of Code Sec. 7701(b)(6). Assume a German citizen obtains his LPR through his U.S. citizen spouse in 2007, but both live predominantly in Germany. If the German citizen files IRS Form 1040NR for the tax year 2008, accompanied by IRS Form 8833, with a valid application of the treaty “tie breaker” rules, without waiving the benefits of the U.S.-German income tax treaty, it is fairly clear that he will have ceased to be a LPR for U.S. taxation purposes for the year 2008.

This is a simple application of a plain reading of the statute. He **commences to be treated as a resident of a foreign country under the provisions of a tax treaty** [Germany] between the United States and the foreign country, **does not waive the benefits of such treaty** [as he did not take any steps to waive the benefits of the treaty—and indeed rather applied them in his circumstances] applicable to residents of the foreign country and **notifies** the Secretary of the commencement of such treatment [which he did when he filed IRS Form 8833]. It seems quite clear that he will no longer be a lawful permanent resident

for tax purposes under the statute. Of course, it is of no real consequence in this factual scenario, since he only obtained his green card in 2007. However, if he obtained the green card in 2000, the analysis becomes quite different, as he should be a “long-term” resident as defined by the statute.

As we continue on with this example, what if the 1040NR tax return was not filed in 2013? Does it matter? When will he cease to be a LPR for federal tax purposes? Does it matter that the German husband has annual income from Germany and other European sources in excess of US\$3M? What if the German husband also owns some U.S. rental real estate property, will that affect the analysis? Should that make any difference? What if he has shares in a German company, yet fails to file information returns as required by Code Sec. 6038, will such failure affect the determination under Code Sec. 7701(b)(6)?; presumably not.

To date, there is no guidance from the IRS on any of these specific questions. Indeed, the IRS has yet to even publish a required taxation form to capture any so-called “covered gifts” or “covered bequests.” More questions are often left in this area than answers.

5. Conclusion

Any LPR who is not residing predominantly in the United States should be aware of the possible loss of his LPR status for immigration purposes, as explained above, but also be aware of how he may cease to be a LPR for purposes of the Internal Revenue Code. The adverse tax consequences can be harsh in such circumstances. Each individual who has a green card in his pocket, but who lives predominantly outside the United States, should carefully analyze how the above tax rules can affect his on-going U.S. tax liability and his immigration status.

ENDNOTES

¹ This trend may not always continue, as applications to U.S. graduate schools were apparently in decline during the Great Recession. See Alison Damast, *Foreign Admits to U.S. Grad Schools Plunge: For the First Time Since 2004, International Admissions to U.S. Graduate Schools Are Down. The Deteriorating Job Market and Problems with Visas and Financing Are to Blame*, BUSINESSWEEK, Aug. 20, 2009, available online at www.businessweek.com/bschools/content/aug2009/bs20090820_960342.htm.

² “Green Card” is the informal or colloquial name given to the lawful permanent resident

(LPR) status of a non-U.S. person. A green card is also known as an “alien registration card” or “Form I-551”.

³ See U.S. Census Bureau Report—*The Foreign-Born Population in the United States: 2003*, available online at www.census.gov/prod/2004pubs/p20-551.pdf.

⁴ See Nancy Rytina, *Estimates of the Legal Permanent Resident Population in 2009*, Office of Immigration Statistics (Nov. 2010).

⁵ INA §101(a)(20); 8 USC §1101(a)(20).

⁶ The Act defines the term “lawfully admitted for permanent residence” as “the status of having been lawfully accorded the privilege

of residing permanently in the United States as an immigrant in accordance with the immigration laws, such status not having changed.” INA §101(a)(20) [8 USC §1101(a)(20)]. The Act defines a special immigrant “returning resident” as “an immigrant, lawfully admitted for permanent residence, who is returning from a temporary visit abroad.” INA §101(a)(27)(A) [8 USC §1101(a)(27)(A)]. An immigrant, whether or not in possession of a valid entry document, may be permitted to enter the United States if he satisfies the definition of a special immigrant returning resident.

ENDNOTES

- ⁷ The Act does not define “abandonment” or “a temporary visit abroad,” and the Act does not otherwise address when an alien’s lawful permanent resident (LPR) status ceases to exist absent an Immigration Judge’s finding of removability after the occurrence of removal proceedings. See *Yakou*, CA-DC, 428 F3d 241, 247 (2005). The Board of Immigration Appeals (the “Board”), however, has long recognized that an alien’s status may change by operation of law, such that an alien may abandon his LPR status without a finding of removability (or, formerly, deportability or excludability) after a formal adjudicatory process. See *Yakou*, CA-DC, 428 F3d 241, 247 (2005) (discussing case law regarding abandonment and holding that an alien may abandon LPR status without formal administrative action); see also *Matter of Quijencio*, 15 I. & N. Dec. 95 (B.I.A. 1974); *Matter of Kane*, 15 I. & N. Dec. 258 (B.I.A. 1975); *Matter of Muller*, 16 I. & N. Dec. 637 (B.I.A. 1978); *Matter of Abdoulin*, 17 I. & N. Dec. 458, 460 (B.I.A. 1980); *Matter of Huang*, 19 I. & N. Dec. 749 (B.I.A. 1988).
- ⁸ See CCA 199935058, (July 8, 1999), CCA 200235026 (July 15, 2002) and FSA 2002 WL 1315688.
- ⁹ For a detailed discussion of these rules, see Patick Martin, “Accidental Americans” Rush to Renounce U.S. Citizenship to Avoid the Ugly U.S. Tax Web, INT’L TAX J., Nov.-Dec. 2012, at 45.
- ¹⁰ See Code Sec. 61 and Reg. §1.1-1(b) and (a)(1).
- ¹¹ See United States Congress Joint Committee on Taxation entitled, *Issues Presented by Proposals to Modify the Tax Treatment of Expatriation* (U.S.G.P.O., June 1, 1995), available online at www.house.gov/jct/s-17-95.pdf.
- ¹² *Id.*, see Appendix B to the Joint Committee on Taxation report.
- ¹³ See Avi-Yonah, *The Case Against Taxing U.S. Citizens*, University of Michigan Law School, Public Law and Legal Theory Working Paper Series, Working Paper No. 190, Mar. 2010.
- ¹⁴ See U.S. Treasury Report, May 1998, “Income Tax Compliance by U.S. Citizens and U.S. Lawful Permanent Residents Residing Outside the United State and Related Issues.”
- ¹⁵ *G.W. Cook v. G.L. Tait*, SCt, 1 USTC ¶ 92, 265 US 47, 44 SCt 444.
- ¹⁶ *C.W. Bowring v. F.K. Bowers*, CA-2, 1 USTC ¶ 293, 24 F2d 918, 923 (1928), cert. denied, SCt, 277 US 608.
- ¹⁷ 9 FAM 42.22 N3 Determining Loss of Lawful Permanent Resident (LPR) Status.
- ¹⁸ 8 CFR §§1.1(p), 1001.1(p).
- ¹⁹ 9 FAM 42.22 N3.4 Loss Due to Deportation.
- ²⁰ 9 FAM 42.22 N3.7 Loss by Reversion.
- ²¹ 9 FAM 42.22 N3 Determining Loss of Lawful Permanent Resident (LPR) Status.
- ²² 9 FAM 42.22 N3.2 Alien Relinquishment of Form I-551, Permanent Resident Card.
- ²³ An alien who wishes to surrender the green card by mail may do so and may include Form I-407 or not, without effect. As of the date of this publication, the I-551 should be mailed along with a Form I-407 to the following address: USCIS Texas Service Center, P.O. Box 850965, Mesquite, TX 75185-0965.
- ²⁴ DHS Form I-407, Instructions.
- ²⁵ (2) CONFORMING AMENDMENTS- (A) Paragraph (1) of section 877(e) is amended to read as follows: (1) IN GENERAL- Any long-term resident of the United States who ceases to be a lawful permanent resident of the United States (within the meaning of section 7701(b)(6)) shall be treated for purposes of this section and sections 2107, 2501, and 6039G in the same manner as if such resident were a citizen of the United States who lost United States citizenship on the date of such cessation or commencement.’. (B) Paragraph (6) of section 7701(b) is amended by adding at the end the following flush sentence: ‘An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.’. (C) Section 7701 is amended by striking subsection (n) and by redesignating subsections (o) and (p) as subsections (n) and (o), respectively.
- ²⁶ IRS Form 8822, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*, available online at www.irs.gov/pub/irs-pdf/f8822.pdf.
- ²⁷ See Reg. §301.7701(b)-7(b) and (c)(1).
- ²⁸ *Supra* note 8 (lawful permanent resident living permanently abroad, subject to withholding as nonresident on payments for U.S. social security benefits, unless he elected to be treated as resident).

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