IMPORTANT EXCEPTION TO US EXPATRIATION PROVISIONS

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Although the number of US citizens renouncing their US citizenship appears to have peaked in 2016, thousands of people each year go through the process of turning in their US passport. Post-expatriation, they will no longer be taxed in the United States on their worldwide income. Part of the necessary analysis for these US citizens is whether they will be considered "covered expatriates" and thus subject to a mark-to-market or exit tax regime under Internal Revenue Code section 877A at the time they give up their US citizenship.

Generally, a "covered expatriate" is any US citizen who relinquishes citizenship, or any long-term resident (an individual who has held a green card at any time in 8 of the last 15 years) who ceases to be a lawful permanent resident of the United States, if the individual (1) has an average annual net US income tax liability for the 5 preceding years that exceeds US$168,000 in 2019; (2) has a net worth of US$2 million or more on the expatriation date; or (3) fails to certify under penalties of perjury that he or she has complied with all US tax-filing obligations for the preceding 5 years, or fails to submit evidence of compliance required by the Internal Revenue Service.

Code section 877A(a) imposes a mark-to-market regime on covered expatriates. This regime provides that all property of a covered expatriate is treated as sold on the day before expatriation for its fair market value. Any gain arising from the deemed sale is taken into account for the taxable year of the sale notwithstanding other Code provisions. The amount that would otherwise be includible in gross income by reason of the deemed sale is reduced (but not below zero) by US$600,000. This amount is adjusted for inflation for calendar years after 2008, the date the provision was enacted. The exclusion amount, as adjusted for inflation for calendar year 2019, is US$725,000.

The mark-to-market regime of Code section 877A does not apply to deferred compensation items, specified tax-deferred accounts, and interests in certain non-grantor trusts. Alternative tax regimes are applicable to certain deferred

compensation items.

However, two important exceptions apply to the general rules of Code section 877A. Specifically, an individual will not be treated as a covered expatriate under the average annual net income tax or net worth tests if

1. the individual (a) became at birth a dual citizen of the United States and another country, (b) on the expatriation date continues to be a citizen of, and is taxed as a resident of, the other country, and (c) has been a US resident for not more than 10 taxable years during the 15-taxable-year period ending with the taxable year in which the expatriation date occurs; or
2. the individual (a) gives up US citizenship before becoming 18½ years old, and (b) was a US resident for not more than 10 taxable years before the relinquishment date.

Many of those seeking to renounce US citizenship fall within the "dual citizen from birth" exception, which can avoid the application of the potentially onerous exit tax rules. For example, consider a child who was born in the United States to two Canadian parents when one of the parents was working for a short stint in the United States. The whole family returned to Canada when the child was 3 years old and the child, who is now 30, has resided in Canada ever since. As long as the child can certify compliance with his US tax-filing obligations for the last 5 years, he can renounce his US citizenship with no exit tax consequences whatsoever, even if his net worth is well above the US$2 million threshold. This exception also often applies to US citizens who were born and remain living in Canada who obtained US citizenship at birth from a US- citizen parent.

The process for renouncing one's US citizenship is now done through an online consolidated system that is run out of the Vancouver consulate. The process requires the completion of forms DS-4080 and DS-4081 and the provision of supporting documentation. A US citizen may request an appointment at a specific consulate or, alternatively, the earliest available appointment anywhere in Canada. A fee of US$2,350 must be paid when the US citizen appears at the US consulate and takes the oath of renunciation. Attorneys are not permitted to accompany an applicant to the consulate. After a number of months, a certificate of loss of nationality, which memorializes the renunciation, will be mailed to the applicant. A number of US consulates have significant wait times; as of August 23, 2019, the current wait times are as follows:

- Ottawa, 5 to 6 months
- Calgary, 3 to 4 months
- Halifax, 6 to 7 months
- Montreal, 8 to 9 months
- Quebec City, 5 to 6 months
- Toronto, 11 to 12 months
- Vancouver, 3 to 4 months

Therefore, Calgary and Vancouver may be the best options for US citizens who want to expatriate in calendar year 2019 and ensure that 2019 is the last year for which they will need to file a US income tax return.