

The Curious Case Of The Accidental American Taxpayer

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In general, the U.S. government primarily imposes its laws and policies on those who live in the U.S. or are otherwise closely associated with the goings-on there. This is, of course, as it should be — despite the occasional propensity of the government to stick its nose where it doesn't belong, the U.S. does not actually have the right to govern the citizens of other nations — but what about those citizens of the U.S. who never asked to be or wanted to be? These people, referred to colloquially as accidental Americans, frequently find themselves between a rock and a hard place, particularly at tax time.



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Who Are Accidental Americans?

Unlike nations, such as Italy, that use bloodlines and ancestry to determine citizenship, the U.S. relies primarily on one key occurrence: birth in the U.S. If someone is born in the U.S., had a birth certificate issued by a U. S. hospital and is not the child of diplomats or other restricted foreign officials, they are generally considered a U.S. citizen. In one fairly publicized case of an accidental American, a woman was born in the U.S. to Canadian parents who were studying abroad. Despite the disinterest of these enterprising scholars in remaining in the U.S. long-term or in raising their daughter to be American, under U. S. law their new bundle of joy was automatically an American citizen.

Confusing? Yes. Frustrating? Also yes. Inconvenient for those who do not realize they are, in fact, citizens of the U.S. until it is too late? Most certainly yes.

Interestingly, this is not the only way to become an accidental American. Lineage can also play a role, with other scenarios that may impose citizenship including:

- Birth to a U.S. citizen parent who has previously had a residence in the U.S.

- Birth to a U.S. citizen parent who was continuously present in the U.S. for at least a year prior to the birth of a child
- Unknown parentage but found to have a residence in the U.S. before age five
- Birth to a U.S. citizen parent who was physically present in the U.S. for at least five years and at least two years after age 14

Essentially, even someone who wasn't born in the U.S., has never lived in the U.S. or planned to live in the U.S. may still be required to pay taxes and may be subject to reporting under the Foreign Account Tax Compliance Act, or FATCA.

The Identification of Accidental Americans

For many accidental Americans, the challenges associated with identification almost diminish the headaches of incidental citizenship. After all, how can the U.S. expect tax returns or foreign bank and financial accounts, or FBAR, filings for those not living in the country with few, if any, ties?

This issue is certainly a cause for concern for the government. FATCA was created in part to address this sort of circumstance. Under FATCA, non-U.S. financial institutions are required to report information regarding potential U.S. persons. If those identified do in fact have ties to the U.S. or are considered citizens, foreign financial institutions are required both to solicit a Form W-9 from taxpayers and report U.S. activity to the [Internal Revenue Service](#) via Form 8699. Those accidental Americans who do not comply are often asked to close their accounts. While not all countries enforce FATCA, many do. This includes the United Kingdom, a common home for accidental Americans.

In addition to FATCA reporting, the IRS has also recently stepped up coordination with taxing authorities of other nations. Through tax treaties, the U.S. government is able to learn more about potential American citizens than ever before, collecting information otherwise unavailable. Disclosure programs, too, are furthering the exchange of information. Reporting by family members with ties to the U.S. has led to numerous audit campaigns intended to uncover noncompliance by individuals living outside the U.S. The government is

also notifying citizens abroad that a failure to comply with reporting requirements can result in the revocation of their passports under Internal Revenue Code Section 7345.

The Tax Obligation of Accidental Americans

As citizen non-residents are well aware, the U.S. is among two countries that impose tax based not on residency but on citizenship. This means that wherever you live, wherever you are, if you're a U.S. citizen, you're going to have to file accordingly. This doesn't necessarily mean you'll owe taxes — under IRC Section 911, U.S. citizens can exclude up to \$80,000 — or the corresponding amount adjusted for inflation — in foreign income annually. For any income not excluded, a tax credit is available in the amount paid to local tax authorities.

Fortunately, these laws essentially negate any tax liability. Over 80 percent of accidental Americans owe no tax to the U.S. government. However, even those sure they won't have a balance due are still required to file and the filing obligations don't stop with a standard 1040. Nonresident citizens may also have to file:

- Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts
- Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner
- Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations
- Form 5472, Information Return of a 25 Percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business

For accidental Americans desperate for a way out, there is one extreme option that can negate filing and reporting requirements — termination of citizenship. While individuals who truly have no ties to the U.S. and do not ever plan on exercising American citizenship may make this election, it's an uncommon choice.

Ensuring Compliance as an Accidental American

As with most things involving the U.S. government, there are many hoops to jump through in becoming — and remaining — compliant as an accidental American. The first step? Getting a passport. Want to relinquish your citizenship and cut ties with the U.S.? You still need a passport in order to give said passport up.

This process is, of course, much harder than it sounds. To get a U.S. passport, a social security number is required. To obtain this, a birth certificate or passport is required. For those born in the U.S., a birth certificate should be available but for those born elsewhere, this requirement is inherently problematic. With no birth certificate, applicants can't receive a social security number and in turn cannot apply for a passport, but to prove citizenship, a passport is necessary. The conundrum here is quite obvious.

Obtaining a passport without a Social Security number is possible, but it requires a whole host of other paperwork. For some accidental Americans, this requires providing any official paperwork that can demonstrate proof of citizenship, including parents' information, marriage certificates or naturalization records. These same forms then may be necessary, in conjunction with a passport, to apply for a Social Security number.

For accidental Americans with proper paperwork, the process can be roughly as painful as filing taxes. For those with limited access to records, simply proving status becomes akin to a waking nightmare.

The Arduous Tax Compliance Requirements

Applying for a Social Security number and passport are good first steps, but they're only the initial steps of many on the road to compliance. The next part? Filing taxes.

For those who have only recently proven citizenship, the next step is to get up to date with the IRS, and that means filing years — potentially years and years — of delinquent returns. While it's not inconceivable that the IRS would require actual preparation of back taxes going back to the first year of earned income, thankfully this is not the case. For accidental Americans, the streamlined filing compliance procedures, which currently use the Streamlined Foreign Offshore Procedures, at least makes getting up to date slightly easier.

Under these rules, participants need to file returns for the three previous years, FBAR for the last six years and pay all taxes due. In a somewhat archaic move, the IRS requires filers to write the words “Streamlined Foreign Offshore” in red at the top of each page submitted. Form 14653, Certification by U.S. Person Residing Outside of the U.S. for Streamlined Foreign Offshore Procedures, must also be included with each form filed.

Normally, late tax filings come with fees, while belated FBAR filings can trigger substantial penalties. However, under this program these sanctions are waived, assuming everything submitted is complete and correct. This is true even if a return is selected for audit — a slightly surprising breath of fresh air for those in pursuit of compliance.

Saying Goodbye to the U.S.A.

For accidental Americans who have no personal ties or who simply have no interest in being further associated with the U.S. — for example, the child born to Canadian parents studying abroad referenced at the beginning of this article — it is possible to relinquish U.S. citizenship, a process known as expatriating. According to IRC Section 1481, a U.S. citizen can give up citizen status by:

- Becoming a naturalized citizen of a foreign country or pledging allegiance to a foreign country
- Serving in the armed forces of a country in a hostile relationship with the U.S.
- Working for the government of a foreign country after becoming a citizen of that country or pledging allegiance to that country
- Formally renouncing citizenship in front of a diplomatic or consular officer of the U.S.
- Providing a written statement of renunciation when the U.S. is in a state of war and the U.S. Attorney General finds that renouncing citizenship is not a risk to national security

- Committing an act of treason against the U.S.

While impoverished or generally middle-class accidental Americans will have no additional steps to take after completing one of these pathways to expatriation — except, of course, committing treason, which should certainly never be an accidental American’s first plan of action — wealthy individuals may need to pay a tax that is assessed on “covered expatriates.” Covered expatriates, essentially a fancy way of saying “expatriates with substantial assets,” are those who: a) have a net worth of over two million dollars, b) had an average net income over \$124,000 for the last five tax years, adjusted for inflation or c) anyone who failed to file Form 8854, Initial and Annual Expatriation Statement, to confirm tax compliance during the expatriation process. This tax is essentially calculated by determining the market value of all of an expatriate’s assets, less \$600,000 adjusted for inflation. So, if an accidental American has a net worth of \$2 million, his burden for tax purposes is calculated based on \$1.4 million.

It is worth noting that most accidental Americans are not covered expatriates and an exemption for those living outside the U.S. can be claimed by filing five years of current tax returns. For all those expatriating, however, a fee of \$2,350 is due and cannot be waived. If this fee is worth bidding the IRS farewell for good — and for some, it is — an appointment can be made with a U.S. consulate or diplomatic office. There the expatriating individual will have the opportunity to sign an oath renouncing citizenship. It is prudent to seek citizenship with another nation prior to this point. If citizenship is renounced and no other citizenship is held, accidental American status quickly gives way to being nationless.

Taxes Due and Expatriation

While a vast majority of accidental Americans don’t owe tax to the U.S., around 18 percent do. Though the amount is generally small, for some individuals the burden of taxation from multiple countries simultaneously is too much to bear. Some simply neglect to pay these amounts. But staying current with tax debt is important for those considering expatriation.

For those with significant U.S. tax debts and no way to pay them, there can be a workaround — provided the IRS is willing to play ball. Under IRC Section 7122, the IRS is permitted to compromise any taxpayer’s liability. That includes those trying to get up to date

in order to move on from the U.S. As such, taxpayers can make an offer in compromise, or OIC, to attempt to settle tax debt. The IRS can reject, accept or even negotiate the OIC to resolve things in an acceptable way. The IRS is also permitted to forgo penalties and interest in order to settle longstanding cases.

OICs aren't limited to those who cannot afford to pay their tax liabilities. In theory, anyone, including accidental Americans of any income level, can file Form 656, Offer in Compromise. When financial limitations aren't a factor, these propositions can be accepted under effective tax administration guidelines, or ETA. If no other grounds for a compromise exist, the IRS can accept an offer provided it can be argued that collecting the original amount would undermine confidence that tax laws are being administered fairly to all taxpayers. This kind of offer is a little more political than a typical OIC. A compromise must be justifiable based on public policy or equity considerations or, alternatively, there must be adequate circumstances to justify compromise, even though a taxpayer in another situation would be able and expected to pay.

As always, the IRS can largely do as it pleases and that means passing judgment on taxpayer proposals. If a compromise offer is struck down, the taxpayer will receive a letter explaining the government's reasoning. Any appeal must be filed within 30 days.

Charting a Course as an Accidental American

Accidental American citizenship raises many complex legal and financial considerations. However, whether citizenship is preserved or all ties to the U.S. are cut, there is no escaping the need to stay up to date on tax and FBAR filings. Adhering to the law may be easier said than done — and no one wants to file taxes more often than they have to — but tax compliance matters for everyone: intentional American, accidental American and everyone in between.

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