

## Passport Control: New Legislation In The US Provides The IRS With Another Tool For Collecting Delinquent Taxes

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### Introduction

While seemingly unrelated on its face, the recently-passed Surface Transportation Reauthorization and Reform ("STRR") Act of 2015<sup>1</sup> should be of significant interest to US taxpayers working outside the United States, or those who frequently travel internationally for business or pleasure. Additionally, all taxpayers with significant outstanding tax matters before the Internal Revenue Service (IRS) should take special note of recent developments that result from this legislation.

The STRR Act (hereinafter "the Act"), which went into effect on January 1, 2016,<sup>2</sup> marks a new era in combating significant tax delinquencies. Under the Act, the US Secretary of State now has authority to, and in some cases is required to, make passport decisions based upon information provided by the IRS. Under the defined circumstances, such action can include denying new passport applications or renewals or revoking currently-in-force passports.

Contained in the "Finance" section of the Act,<sup>3</sup> the apparent intent of the new passport rules is to encourage compliance with past and present tax matters. It would seem that Congress's hope is that these new rules will inspire an in-flow of funds from currently-outstanding tax liabilities. Importantly, this marks one of the first times that the US Internal Revenue Service and the US State Department will share information to combat significant tax deficiencies.

## **Transportation Funding Act Of 2015 – Consequences To Passport Holders And Applicants**

Under the Act, the Secretary of State can make passport determinations related to tax matters for taxpayers with "seriously delinquent tax debt" of more than USD50,000.<sup>4</sup>

### ***i. Seriously Delinquent Tax Debt***

Taxpayers that have significant outstanding tax matters with the IRS may see their passport, or passport application, affected directly. For the purposes of the Act, a tax debt is considered "seriously delinquent" if a notice of lien has been filed in public records, or a notice of levy has been filed.<sup>5</sup> Under current practices, the IRS provides written notice to taxpayers receiving notices of lien or levy.

For new or renewal passport applications made by persons with seriously delinquent tax debt of more than USD50,000, the Secretary of State is *required* to deny any such application.<sup>6</sup> Additionally, for taxpayers with currently-in-force passports, the Secretary has the authority to revoke such passports.<sup>7</sup> In cases of revocation, a current passport may be limited to only allow US return travel, or a new temporary passport may be granted for this purpose.<sup>8</sup>

### ***ii. Exceptions***

Notwithstanding the potential for denying or revoking a taxpayer's passport, the Secretary retains the authority to issue a passport to otherwise-covered individuals for emergency circumstances or humanitarian reasons.<sup>9</sup>

Taxpayers with greater than USD50,000 of outstanding tax debt, but whom are currently making payments under an IRS-approved repayment plan, are exempt from these rules.<sup>10</sup> Also exempted are those debts from which collection is suspended pending a Due Process hearing.<sup>11</sup>

## **Incentive For US Taxpayers Living Abroad To Become Compliant**

The new passport rules should incentivize taxpayers to become compliant and up-to-date with their tax matters. This is especially true for US taxpayers living abroad, and those taxpayers that

travel internationally on a frequent basis under a US passport. While compliance may appear a daunting task, taxpayers need not panic at the idea of catching up on prior returns. Under US tax law, certain relief may be available for taxpayers living abroad to reduce their overall US tax liability.

First, US citizens and residents may be eligible to claim a foreign tax credit for taxes paid to another country.<sup>12</sup> This credit is available for taxes paid on income that is earned in a country abroad. Therefore, while US taxpayers may otherwise have a large US tax liability, a foreign tax credit may help to reduce or eliminate any such liability.

Second, US citizens and residents may also be eligible to exclude a portion of their taxable income under the Foreign Earned Income Exclusion.<sup>13</sup> For 2016, the maximum eligible exclusion amount is USD101,300.<sup>14</sup> This exclusion is a reduction to US gross income,<sup>15</sup> thereby directly reducing the amount of income that is subject to tax in the US. In order to qualify for this exclusion, a taxpayer must either have a "tax home" in a country located outside the United States for an entire calendar year, or must be physically present in a foreign country (or countries) for more than 330 days in any consecutive 12-month period.<sup>16</sup>

However, a taxpayer must ultimately file a US tax return to claim these benefits. Taxpayers looking to claim these benefits for either the current tax year or prior years should consult a tax professional who has familiarity with globally mobile taxpayers. Even if the deadline to file a tax return for a prior year has passed, a taxpayer still has an obligation to file a return for that year. By seeking assistance with filing a US tax return and claiming benefits such as the foreign tax credit or foreign earned income exclusion, a taxpayer should be able to reduce their US tax liability.

In sum, there are significant relief options available to globally mobile US taxpayers. As such, maintaining compliance need not result in significant US tax liabilities. However, claiming such benefits can pose certain challenges to US taxpayers. For example, US tax returns for individuals living abroad are more frequently selected for further review by the IRS. While often times these issues are easily resolved, a taxpayer must be able to maintain regular avenues for receiving IRS correspondence to do so.

### **Considerations For Revoking Permanent Citizenship**

For some US taxpayers living abroad, these new passport rules could prove to be the tipping point to considerations of revoking their US citizenship. For these taxpayers, who are taxed on a worldwide basis regardless of where they are personally living and working or where other

income sources are located, may now risk losing their passport privileges if major disagreements with the IRS arise. For this, and other reasons, citizens and permanent residents may occasionally seek to weigh citizenship benefits with ongoing compliance requirements. While there are numerous other considerations for this decision, certain US tax concepts should at least be analyzed.

In 2008, the United States passed the Heroes Earnings Assistance and Relief Tax ("HEART") Act, which defines the current "expatriation" rules in the US.<sup>17</sup> Under the HEART Act, US citizens or green card holders who relinquish their citizenship or green card may be subject to an "exit tax." Under the exit tax, a "covered expatriate"<sup>18</sup> is essentially treated as if all of the taxpayer's assets were sold on the day before expatriation.<sup>19</sup> Any resulting gain recognized upon this "sale" would then be reportable on the taxpayer's current-year tax return.<sup>20</sup> Depending on the total value of the taxpayer's investments at the time of expatriation, this deemed sale can have a significant impact on the overall cost of relinquishing citizenship or permanent residence.

The HEART Act sets out certain other definitions for whom the act applies to, which types of assets are included, and applicable exceptions and special rules. Such topics are beyond the scope of this writing, but are nonetheless important considerations for any individuals considering relinquishing citizenship or green card status.

## **Conclusion**

In summary, the recently passed legislation creates additional considerations for US passport holders when maintaining their US tax compliance status. If a US taxpayer has a significant tax debt of greater than USD50,000, this taxpayer's passport status may become jeopardized.

Maintaining compliance with the US tax law need not result in overly burdensome requirements or expenses. By utilizing relief methods such as Foreign Tax Credits or the Foreign Earned Income Exclusion, many taxpayers may be able to significantly reduce, if not fully offset, their US tax liability. However, claiming these benefits nonetheless requires that a return be filed, and correspondence from the IRS addressed in a timely fashion. Furthermore, IRS system limitations may prevent taxpayers from including complete foreign addresses on their US tax returns. As a result, such important correspondence may be significantly delayed, or in some cases, lost completely. For this reason, the new passport rules create an even stronger incentive for taxpayers to carefully consider the address being used on a US tax return. Using a US address and forwarding service

may allow a taxpayer a greater opportunity to respond to IRS notices and receive final notices of levy or lien before their passport becomes at risk.

It is also important to keep in mind that the IRS will determine the amount of tax debt based on the information it has available. If an individual has not filed a US tax return for a given year, the IRS will determine the outstanding liability without taking into account the potential benefits of the Foreign Tax Credit or Foreign Earned Income Exclusion. Thus, it is extremely easy for an individual who has not filed a return to have outstanding tax debt with the IRS in excess of USD50,000, even if the individual's actual liability is much lower.

Finally, for US citizens and long-term permanent residents considering revoking their current status, the HEART Act should be carefully reviewed to determine if any exit tax concepts apply to their situation.

Needless to say, these new rules give the IRS an effective tool to use to bring US taxpayers into compliance and to accelerate the collection of tax liabilities. For some US taxpayers, this may compel them to address whether to maintain their US citizenship. For others, this could be the motivation they need to get their tax affairs in order.

## ENDNOTES

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- <sup>1</sup> The "Surface Transportation Reauthorization and Reform Act of 2015" was signed into law by the President on December 4, 2015. See Fixing America's Surface Transportation Act, H.R. 22, 114th Cong. § 32101 (2015). The Act amends Subchapter D of chapter 75 of the Internal Revenue Code to add a new Section 7345. *Id.* § 32101(a). Further citations to the actual text of the amendment will refer to the code section contained in the Internal Revenue Code.
- <sup>2</sup> *Id.* § 32101(f).
- <sup>3</sup> *Id.* § 30001.
- <sup>4</sup> This USD50,000 threshold is adjusted annually for inflation. IRC § 7345(c).
- <sup>5</sup> IRC § 7345(b).
- <sup>6</sup> See IRC § 7345(d)(1)(A) ("[T]he Secretary of State *shall not issue* a passport to any individual who has a seriously delinquent tax debt ...") (emphasis added).
- <sup>7</sup> IRC § 7345(d)(2)(A).
- <sup>8</sup> IRC § 7345(d)(2)(B)(i)–(ii).
- <sup>9</sup> IRC § 7345 (d)(1)(B) & (e)(1)(B).
- <sup>10</sup> IRC § 7345(b)(1) (referring to agreements under IRC § 6159 & § 7122).

- 11 IRC § 7345(b)(2).
- 12 IRC § 901(b) (allowing for a credit based on foreign taxes paid or accrued during the taxable year).
- 13 IRC § 911(a).
- 14 Rev. Proc. 2015-53, 2015-44 IRB 32.
- 15 IRC § 911(a).
- 16 IRC § 911 (d)(1)(A)–(B).
- 17 See Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. No. 110-245 § 301; IRC § 877A.
- 18 A "covered expatriate" includes all US citizens, as well as green card holders, who held their green card status for at least eight of the fifteen preceding tax years before expatriation. See IRC § 877A(g)(1)(A)–(B).
- 19 IRC § 877A(a)(1).
- 20 IRC § 877A(a)(2).