

The Gift of Worldwide Taxation

Parents must realise in full the tax implications they are bestowing on the child

By Jeff Trinklein

Expectant parents dream that their children will have more opportunities than them - for example, access to better education, a different perspective on the world, or a chance for a well-paying job in a dynamic economy.

As one way of achieving these dreams, some parents seek to provide the gift of US nationality by arranging their lives so that their child is born in the United States. Indeed, many residents of the Gulf are US citizens because their parents were studying or working in the US when they were born.

Under the US Constitution, birth in the United States conveys an automatic right to citizenship. But anyone considering giving the gift of US citizenship to their child, or anyone who received that gift themselves from their parents, must understand that it has a cost under US tax law - one that is ignored at the individual's peril.

For anyone facing these circumstances, here are some basic points to keep in mind:

US citizenship is automatic

Any child born in the US acquires nationality at birth, except in very rare circumstances - for example, a child born to a parent with full diplomatic immunity.

US citizens are subject to tax without regard to residence

Every US citizen is subject to US tax, regardless of whether he or she resides in the US. This rule, which is different than the tax rules of most other countries, applies even if a US citizen has never lived in the US or has not lived in the US for many years.

All income worldwide is taxed

Any US citizen (or, indeed, any US permanent resident) must pay US tax every year on his or her worldwide income, at rates of up to about 43 per cent on certain types of income.

Applying for a passport is irrelevant

Being taxed as a US citizen occurs regardless of whether the citizen holds or even applies for a US passport. In fact, many US citizens living in the US never apply for a US passport, but they are still US citizens and subject to US tax on their worldwide income.

Renouncing the nationality does not terminate US tax obligations

If a US citizen marches to the US Embassy, renounces the citizenship and surrenders the passport, he or she is still taxable in the US on her worldwide income. Under current law, they will be liable for US tax on the worldwide income for potentially the rest of their lives, unless they file a special IRS form and files complete tax returns for the last five years.

The IRS will eventually find out whether you are a US citizen, even if you live in the Gulf

In the past, US nationals living abroad might have hoped that the IRS would never find them, particularly if they held a non-U. S. passport. Those days are over. The US government has agreements with over 100 countries to make sure that foreign banks collect information about US citizen accountholders and report that information to the IRS.

In fact, a foreign banker may be required to ask follow-up questions if an accountholder was born in the US, was educated in the US, or has other significant ties with the US. If these questions are not addressed to the bank's satisfaction, the bank may close an existing accountholder's account or may decline to open a new account for a prospective accountholder.

Don't forget inheritance tax obligations

Inheritance tax (or the “estate tax” as it is known in the United States) can consume up to 40 per cent of the worldwide property of a US citizen who dies without adequate estate planning.

The US estate tax applies without regard to the residence of a US citizen descendant, and applies without regard to the nationality or residence of the decedent's heirs.

Today, persons born as dual citizens can renounce their US citizenship under a special amnesty programme by filing five years of tax returns and paying taxes plus interest, but without having to pay penalties.

But the amnesty will not last forever, and can be withdrawn by the IRS at any time. The IRS has even hinted publicly that the programme may be coming to a close in the near future.

Given the relative ease of sharing and assimilating large amounts of data, it is only a matter of time before the tax authorities of other countries match the vigour of the IRS. Nevertheless, it will always play an oversized role in the tax compliance and enforcement context due to the unique breadth of US tax rules.

So, for anyone considering the gift of US citizenship for their new born child, congratulations on the birth of your child - but just remember to calculate the full price of the gift!

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