

# Little Archie's big tax problem

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Prince Harry and Meghan, Duchess of Sussex, joined by her mother, Doria Ragland, show their new son to the Queen and Prince Philip at Windsor Castle (Chris Allerton/SussexRoyal via AP)

New parents have so much to worry about, and British royals are no exception. Settling into feeding schedules, battling sleep deprivation and fending off the paparazzi are all part of life with a new baby for Meghan and Harry.

In addition to all that, the Duke and Duchess of Sussex have to contend with something no British royal couple has ever tackled before. Behind the scenes, an army of accountants and lawyers has likely been hard at work analyzing every income stream and asset the family holds. Investment structures must be re-considered. Works of art, furniture and jewelry must be appraised. At Meghan's wedding and baby showers, the value of every gift and the citizenship of its giver must be noted and tallied.

All this bean-counting is necessary because Meghan and her new son, Archie, are American citizens. And that means they—and the rest of the royal family—have a big, fat tax problem.

Children born outside the U.S. are American citizens if they have at least one American parent who lived in the U.S. as an adult. Most experts agree that thanks to his American mother, Archie must comply with the Internal Revenue Service's rules until he's old enough

to renounce his citizenship, with Meghan stuck filing U.S. tax returns until she becomes a Brit or longer. Shortly after Meghan and Harry announced their engagement, a spokesperson for Kensington Palace told CNN it was “too early to say” whether Meghan would keep her U.S. citizenship, with no word on the family’s plans for Archie yet.

The U.S. is the only developed country in the world that taxes based on citizenship rather than residency, making Archie and Meghan two of nine million American citizens living abroad trapped in a lifelong quagmire of paperwork, severely restricted financial choices and the threat of heavy penalties if they get something wrong. And the requirement to comply starts at birth, with the U.S. even requiring minors to file tax returns if they make more than US\$12,000 in employment income or US\$400 in self-employed income.

“It’s outrageous. It’s immoral,” said John Richardson, a Toronto-based lawyer who works with U.S. citizens living abroad and who advocates for U.S. tax reform for non-residents. “It imposes very, very punitive reporting requirements.”

With the June 15 filing deadline for American citizens living abroad fast approaching, about one million U.S. citizens living in Canada are currently joining Meghan in preparing their 2018 U.S. tax returns. Since there’s no age limit on the reporting requirements, Archie’s first return may follow suit next year. Here are some of the things experts say the royals will need to keep in mind.

## **Income**

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Infants under the age of one don’t typically earn any income, but Archie is not your typical infant. Because he comes from a wealthy family, he might already be the beneficiary of inheritances earning interest and dividends, or own corporate shares. If he earns at least US\$1,050 from such sources of “unearned income,” he’ll have to file a tax return. Thanks to a credit for income tax paid in another country, Archie will only owe tax to the U.S. if the Americans tax that type of income at a higher rate than the U.K.

“I would imagine that since Archie comes from a wealthy family, he probably already has some bank accounts and investments in his name,” says David Treitel, founder of the U.K.-based firm American Tax Returns Ltd. “He could potentially be filing as early as April 15 of next year.”



Archie during his first photo call (Dominic Lipinski/Pool via AP)

A pitfall U.S. citizens living abroad often fall into is investing money in accounts that earn tax-sheltered interest in the country where they live, but whose earnings are subject to taxation by the U.S. Canadian examples include tax-free savings accounts and registered education savings plans, which experts typically advise Americans not to hold. The U.K. has similar savings vehicles called individual savings accounts, or ISAs. Tax experts also generally advise Americans against holding foreign mutual funds, because the U.S. taxes them at a high rate and the reporting requirements are onerous. If Archie were to hold a foreign mutual fund inside one of these foreign tax-sheltered savings vehicles, as many people do, he would be in double trouble.

“You would avoid it,” says Sam Ashley, U.S. tax director at the U.K.-based firm Tax Advisory Partnership. “It’s a tax-free investment in the U.K., but if you have to pay tax at 37 per cent in the U.S., it takes away the benefit of that investment completely.”

Archie could also meet the requirement to file a U.S. tax return if he earns income in excess of certain limits. Again, he likely won’t actually owe any taxes on this money. If he happens to make any money while visiting family or during a U.S. tour, however, the Americans will get to tax it first.

## Gifts

It’s always a good idea to keep track of who gave which gift at a bridal, wedding or baby shower, to make it easier to send thank you notes. For Meghan, however, the IRS may well want that information too. Americans must report gifts from non-U.S. citizens worth more

than US\$100,000 each, or worth a combined total of US\$100,000 if the gift-givers are related. For example, if Prince Charles gave Meghan a painting worth US\$40,000 and Prince William gave her a necklace worth US\$60,000, she would have to report both gifts. Since royals receive a lot of high-value gifts, this requirement is likely to keep their accountants very busy.

“Everything that’s received has to be tracked in terms of its value,” Ashley says. “Family heirlooms would have to be appraised.”

## Reporting financial holdings

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The U.S. government doesn’t just want to know how much income its citizens are earning. If Archie has money in non-U.S. accounts worth an aggregate total of at least US\$10,000, Uncle Sam also requires a thorough breakdown of where that money is. U.S. citizens are required to report the tax year’s maximum value in every checking account, savings account, investment fund, retirement savings plan, pension plan and life insurance policy they hold, including joint accounts and any corporate accounts they have signing authority over. Archie likely has someone to tally this all up for him, but regular American citizens have to go through a mind-numbing annual exercise of highlighting the maximum value in every monthly statement for every single account they hold.

If Archie’s guardians and accountants neglect to report an account or investment and the IRS determines they left it out on purpose, the penalties are steep. The U.S. can demand up to 50 per cent of the value of each account per year, which can quickly add up to more than the account held in the first place.

For Archie and Meghan, the reporting requirements may not stop with accounts in their own names. Richardson, the Toronto-based lawyer, points to section 318 of the Internal Revenue Code, which states the U.S. considers Americans to be the owners of any shares their spouses, parents and grandparents own, even if those family members are not U.S. citizens. As long as the shares aren’t in Meghan or Archie’s names, and the American royals don’t own any stock in corporations that hold the shares members of the royal family own, this will only be a reporting requirement and they won’t actually owe any U.S. tax when the shares are sold.

The fact Meghan may have to report her baby shower gifts to the IRS is amusing, but Richardson says this lesser-known rule is much more serious for members of the royal family. Harry and even Charles may be forced to disclose their notoriously private finances to a foreign authority, running the risk of embarrassing leaks.

“Make no mistake about it: This is not a problem that’s somehow isolated to Archie growing up,” Richardson says. “He lives in the context of a family.”

## Renouncing

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America has its perks. Many of its states have pleasant weather. Its selection of snack foods is globally unparalleled. In some states you can legally smoke marijuana, which is not currently the case in the U.K. And yet, Archie and Meghan may decide the benefits of American citizenship are not worth the trouble of exposing the royal family to the financial equivalent of a strip search every year.

Meghan will be able to renounce her American citizenship once she becomes a British citizen, a process that will take at least a few years. Archie will have to wait longer. The U.S. government frowns upon minors renouncing their citizenship before they're old enough to understand the implications and generally makes them wait until they're at least 16, or reach the age of majority at 18. It's up to the embassy official reviewing the case to determine whether the minor is being pressured by his parents and decide whether to let him renounce.

Archie and Meghan will each have to pay a fee of US\$2,350, which the Americans hiked up from US\$450 in 2014 after a crackdown on foreign tax compliance sent record numbers of citizens running for the exits. There's an obvious correlation between the date the U.S. implemented that crackdown and the year when renunciation numbers started to spike, but Americans aren't supposed to renounce in order to avoid their taxes and can be barred from entering the country if they do. If Meghan's net worth is more than US\$2 million when she renounces, she'll also be liable for the hefty exit tax, with the U.S. assessing any gains in excess of US\$713,000 on Meghan's assets as if she sold them the day before renouncing. Archie will be exempt from the exit tax as long as he continues to live in the U.K., where he was born.

Another obligation the U.S. imposes on its male citizens may help Archie make the argument he has reasons other than taxes to renounce. Within 30 days of his 18<sup>th</sup> birthday, the U.S. will require him to register for the selective service, so they know where to find him in the event of a military draft. Treitel, of American Tax Returns Ltd., says Archie has a good case to make that this is not appropriate for a British royal.

"There's obviously some danger in the future he could fight for an army of a country that's not Great Britain," Treitel says. "With his strong royal connections and loyalty to the United Kingdom, being loyal to another country is not an appropriate thing."

Another option available to the royals: simply act as if Archie were not a U.S. citizen at all, never registering him for a social security number or filing tax returns in his name. While most experts agree Archie is a citizen under U.S. law, forcibly imposing that law on a citizen and resident of another country is another matter. The royals could decide to bet the Americans will balk at the high-profile international court case and media circus they would create by trying to impose penalties on Archie for failing to file.

## The bigger picture

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American expat organizations have been fighting to change their country's citizenship-based taxation system for years, but the compliance burden and costs have only grown. Since they have limited voting power, there's little incentive for politicians to champion the cause.

Richardson, who is among those pushing for change, says the attention Archie's citizenship is bringing to the issue may not be all that helpful. He says Americans have the impression that anyone living abroad or holding money in foreign bank accounts must be rich—an impression Archie and Meghan's situation doesn't exactly contradict. The Americans who are most affected, however, are ordinary people trying to make a living from freelance income or surviving off retirement savings, who face punitive tax treatment from a country they don't live in, and who can't benefit from the services those taxes are funding.

"It goes way beyond its impact on individuals," Richardson says. "It has a huge impact on the retirement planning system of other countries, the ability of people to participate in the normal retirement planning tools available to them."

The Duchess of Sussex may not have much in common with those ordinary Americans any more. But she and Harry do have to submit to the same joyless experience of having every financial move cleared by an accountant or lawyer with U.S. tax expertise.

"One of the most important factors in the success of a marriage is the ability to make decisions together," Richardson says. "You have to have the tax advisors in the marriage. Do you want that?"

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