U.S. Expats With Passports Revoked for Tax Debt Face Major Woes

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U.S. expatriates with large tax debts may find their ability to work and live overseas jeopardized when the government starts revoking their passports, as soon as this month.

The agency in July began sending letters to some indebted taxpayers saying it will ask the U.S. State Department to revoke their passports, according to its website. People who live abroad and receive the letter have 90 days to call the government and set up a payment plan, the IRS said in an email. For domestic taxpayers a response is required in 30 days.

A valid passport is often a requirement for acquiring a work visa, obtaining a mortgage, or opening a bank account overseas—making passport revocation a serious problem for U.S. citizens living and working abroad. It can also curtail their ability to travel between countries.

"The impact on overseas Americans is potentially much more grave than for domestic Americans," said Jonathan Lachowitz, chairman of the advocacy group American Citizens Abroad.

The IRS has the authority to ask the State Department to deny or revoke passports of taxpayers with "seriously delinquent tax debt" of $52,000 or more under a provision in the 2015 Fixing America's Surface Transportation Act. The agency began implementing the program at the beginning of 2018.

The agency had sent almost 389,000 certification notices to taxpayers as of May 17 this year, according to the Taxpayer Advocate Service. The notices warn people that they've been identified as having substantial tax debt and could face repercussions under the passport program. The IRS can direct the State Department to deny passport applications or renewals until an agreement for paying back the IRS is reached. The agency may request revocation of an individual's passport in more extreme cases.

Lachowitz said he expects a substantial number of the individuals receiving those messages to be U.S. expatriates.

More than 8 million U.S. citizens—excluding those in the military—are estimated to live overseas.

Some U.S. expatriates might not even know they're in any danger, said David McKeegan, the co-founder of Greenback Expat Tax Services, which specializes in preparing U.S. tax returns for American expats.

A government watchdog previously pointed out that the IRS struggles to correspond with taxpayers living abroad.

The IRS said it is aware that mail takes longer to deliver overseas, which is why the agency is allowing extra time for people to respond when passport revocation letters are sent abroad.

Racking Up Debt

It isn't difficult for people living overseas to rack up more than $52,000 in tax debt. The rules for expatriates are complicated, making errors on the part of both taxpayers and the IRS common, practitioners said.

U.S. expats are required to file U.S. taxes and report their income even if they are permanent residents or citizens of a foreign country. There are some benefits and special rules that can be applied to reduce double taxation. They are also obliged to report their foreign assets under the Foreign Account Tax Compliance Act.

"We see taxpayers with a lot of misunderstandings," said Sean McMahon, a Boston-based tax lawyer and former senior attorney with the IRS Office of Chief Counsel.

On the IRS side, it's not uncommon for agency employees to reach different conclusions on two separate situations with very similar facts—meaning taxpayers end up having to go through the appeals process to get clarification, he said.

There are also individuals who have had an existing problem but aren't particularly worried about addressing it since they no longer live in the U.S., McMahon said. When they finally sit down to resolve the issue, the amount of penalties and interest that have built up over time can be substantial, he said.

Tax debt can grow especially fast in situations where expatriates don't file a return at all, McKeegan said. In those situations, the IRS will file a substitute return for the taxpayer that calculates the person's tax bill based on the "worst case scenario." The agency won't take into account deductions and exemptions the taxpayer may be entitled to.

What's At Stake?

The passport revocation program is having the desired effect, in the sense that international taxpayers, who may not have had enough incentive to come forward before to settle up with the IRS, now have no choice but to pay attention, McMahon said.

"We've seen a definite increase in the number of clients telling us that that is why they're coming forward to deal with their tax problem," he said.

At the same time, the agency should consider a hardship exception for expatriates because the consequences can be so dire, especially if their U.S. passport is their only passport, he said.

“For an overseas American, a valid US passport is often the only means of identification valid for establishing or maintaining residency in that person’s city of residence and employment; opening a bank account; obtaining a mortgage or other loan; registering at university; obtaining a marriage license, etc.,” the Association of Americans Resident Overseas said in a 2019 position paper.

People living in the U.S. have less to worry about, unless they frequently travel abroad for work.

A majority of Americans still don’t have passports, though the number who do has grown substantially over the last several decades. In 2018, 137.6 million—or about 40%—of Americans had valid passports, according to data from the State Department.

So passport revocation may not be the best way to motivate people living in the U.S. to pay off their tax debts, McKeegan said.

For U.S. expatriates, though, “it can be really dangerous,” he said.