



Taxing Americans Abroad – Congress Draws Breath

By Charles Bruce

Americans abroad are like my Uncle Jube. He was very quiet and lived far away. I remember him for whittling wonderful slingshots for me and my brothers.

It's terrible, but we always forgot he was there and, quite wrongly of course, forgot to invite him to Christmas lunch and grandchildren's graduations. Congress is the same way with Americans abroad. Congress just forgets that they're there.

With the mad rush to approve the tax reform bill just before Christmas, Congress – at least the Republicans in Congress – was hell-bent to make changes, and at the top of their list was changes to make US corporations no longer taxable on their foreign income. In layman's language, this is known as "territorial taxation", because it taxes domestic, meaning US, income but not foreign income.

The same concept can, if Congress chooses, apply to US citizens resident in a foreign country. Here it's called "residency-based taxation". Every other country in the world, except beleaguered Eritrea and maybe North Korea – but who wants to call up the North Korean tax authority and ask! – follows an RBT approach.

The US, as everyone knows or should know, taxes US citizens on their worldwide income regardless of source, regardless of real connections with the US, regardless of anything. That's why the great American diaspora at this time of year is scrambling to gather tax records and wade through a pile of tax forms, all to the end, in many cases, of not owing any tax. A guess is that 5 or 6 million Americans abroad file or should file federal tax returns, and many of these result in, after tax credits, exclusions, and the like, zero taxable income and therefore zero tax. In fact, as a group, they may be sitting on a mound of unused tax credits.

With headline-grabbing tax reform out of the way, Congress appears ready to turn to the subject of taxing Americans abroad, who are making for sensible changes.

Not only did Congress not convert the rules from citizenship-based taxation to residency-based taxation, but in providing good things to domestic corporations, they 'short sheeted' American individuals abroad in several ways. The new territorial tax benefits don't apply to individuals and certainly not individuals abroad. A

nasty little rule that says that accumulated earnings in a controlled foreign corporation – think about a British software corporation majority-owned by a bunch of Americans who for some reason decided they like British weather more than California weather – will be "deemed" distributed to these lads and lassies, and taxed as ordinary income, regardless whether anything was actually distributed to them. There's more. Weirdly constructed, amazingly complicated rules produce a significant rate reduction for participants in a so-called passthrough entity, like a partnership. This was done to even up things a bit between corporations, which got a big rate reduction, and non-corporate businesses. Wonderful. The problem is: This only applies only to domestic US income, not to foreign income. Our friends in North London, if organized as a partnership, are obviously earning overwhelmingly foreign income. The benefit for passthroughs does not help them.

There are other things like this new or recently added to the code, but point made.

Americans abroad are mighty unhappy, putting it nicely. But there are a few positive things. Congress today is much more aware of the situation than they were, say, six months ago. Yeoman's work has been done by people on all sides of the spectrum, including a number of Republican-related groups, Democrats Abroad, several overseas American Chambers of Commerce, Americans for Tax Reform, and others. American Citizens Abroad, a nonpartisan organization with overseas chapters, including one in UK, and an office in Washington, DC, has been especially active. www.americansabroad.org.

Switching to residency-based taxation for sure is possible and, in my view, trending towards likely. Now's the time for everyone to push hard. Now's the time for Congress to hold hearings where everything can be put on the table.

And, please Congress, don't forget to invite Uncle Jube. ★

Charles Bruce is Chairman of American Citizens Abroad Global Foundation, which funded the revenue estimates prepared by District Economics Group. Michael Larson, Chairman, ACA UK Chapter contributed to this article.