

[Headlines - Paul Merrion commentary: For some, costs of US citizenship far outweigh the benefits](#)

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In my secret agent fantasies, I always thought it would be cool to have two passports. One for inconspicuously traveling the world without the "Ugly American" label, the other for going through Customs in the short line at Dulles International.

It's a reality for many who live overseas but were born in the US, which unquestionably made them US citizens, at least until President Donald Trump stirred the pre-election pot by saying he can end birthright citizenship with an executive order.

Few agree the US Constitution's 14th Amendment can be so easily trumped, but he might be on to something if he would somehow limit it only to taxation.

It's starting to dawn on policymakers here and on millions of Americans living abroad that the new tax law has exacerbated the downside of being a US citizen if you don't live in the US, not to mention the administrative headache it's going to create for the Internal Revenue Service.

Unlike every country in the world except war-torn Eritrea, which needs all the revenue it can get from its millions of refugees living in diaspora, the United States taxes US citizens forever, no matter where they live or what other citizenship they hold.

Obviously, this prevents wealthy tax cheaters from establishing citizenship somewhere else to escape the IRS. But it also ensnares at least 5 million US citizens living abroad who have little or no real connection to the country where they happened to be born.

This has long been an annoyance, but not a real problem until lately. After deducting foreign taxes paid from their US tax bill, many ended up owing nothing to Uncle Sam, so it was more of a reporting hassle for those who complied.

In recent years, new reporting requirements for US taxpayers with foreign bank accounts applied to expatriates who haven't been on US soil in decades, or even since they were born. They must now spend time and money filing the required reports with the IRS or face huge penalties, even if they owe no tax on their investment returns. As a result, advocates for Americans living abroad say many foreign banks refuse to do business with anyone who can be classified as a US citizen.

The latest wrinkle is the new law's transition tax on foreign assets. This one-time levy is aimed at repatriating hundreds of billions of dollars of profits US-based multinationals stashed in their foreign subsidiaries when US taxes were relatively higher.

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But there's nothing in the new tax law to prevent it from applying to mom-and-pop businesses in foreign countries owned by expats who are still US citizens.

At an Oct. 22 IRS hearing on proposed regulations for the transition tax under [Section 965 of the Internal Revenue Code](#), representatives of multinationals and the oil industry pleaded for relief from some technical intricacies of international tax accounting overlooked by House and Senate Republicans in their rush to get the tax bill enacted last year.

But the most poignant plea came from American Citizens Abroad, a nonprofit group that's been advocating for better tax treatment for expats for more than 40 years.

Small business owners should be exempt from the transition tax, the group argued, because individuals don't benefit from the dividends-received deduction that multinationals get.

"It should be obvious to everyone that a *de minimus* rule is necessary to take out from under the workings of the regulations small taxpayers," said Marylouise Serrato, ACA's executive director, at the hearing.

"There can be no justification for requiring an American owning and operating a restaurant in Bergen, Norway, with very little in the way of undistributed, non-previously-taxed post-1986 foreign earnings of the business, to calculate and pay the transition tax. If he doesn't comply, not only will he owe the tax but also penalties and interest," she said. "In the true sense of the word, this result is absurd."

In addition, applying some of the tax code's most complicated provisions to tens of thousands of small taxpayers and eventually auditing at least some of them "would be a waste of valuable IRS talent," she added. "Stepping back, the Treasury Department, in our view, is not well informed about the situation of Americans abroad. These regulations, in the eyes of tens of thousands of individuals living overseas, are maddeningly cavalier."

Her point is buttressed by a lawsuit now pending in Canada, which goes to trial in January. A Canadian nonprofit called the Alliance for the Defence of Canadian Sovereignty is suing Canada's attorney general and its National Revenue minister to overturn an intergovernmental agreement that allows Canadian banks to comply with US law, namely the Foreign Account Tax Compliance Act.

If not for the agreement, Canadian banks would run up against that country's privacy laws if they filed FATCA reports on Canadian account holders. The arrangement allows the banks to file the reports with the Canadian government, which then reports to the IRS.

The lawsuit argues the agreement violates the Canadian Charter of Rights and Freedoms, the equivalent of the US Constitution's Bill of Rights. The named plaintiffs are two Canadian citizens who were born in the US to Canadian parents. One hasn't lived in the US since she was five years old, roughly 46 years ago.

The issue tests whether Canadian protections against search and seizure and privacy violations can be trumped by US tax law, as well as the central government's authority to require locally regulated banks to comply with the intergovernmental agreement.

"Simply, Canada does not have jurisdiction to direct a provincially regulated financial institution to transfer private information about property it holds in trust for its customers - the Accountholder Information - to Canada for further distribution to a foreign state," according to the plaintiffs' brief.

Meanwhile, a coalition of right-leaning taxpayer interest groups recently weighed in on the side of paying taxes based on residence, rather than citizenship. In a Sept. 19 letter to the chairmen of the House and Senate tax committees, the National Taxpayers Union and 10 other groups called for residence-based taxation for individuals in any upcoming tax legislation.

Burdens imposed by citizenship-based taxation "include a narrow Foreign Earned Income Exemption, the Foreign Account Tax Compliance Act, Federal Bank Account Reports, and now unintended consequences of the [Tax Cuts and Jobs Act's] repatriation/transition tax and the Global Intangible Low-Taxed Income Regime," said the letter,

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which included support from Americans for Tax Reform, Tea Party Nation and the Center for Freedom and Prosperity.

No matter your political view, it's hard to argue with their central point: "No other advanced country imposes extraterritorial tax jurisdiction on its own citizens," the letter said. "American tax law is the aberration."

One of the new tax law's biggest achievements was to shift business taxation to a territorial basis, bringing the US in line with most other countries' tax systems, they noted.

"Doing likewise for overseas Americans doesn't just benefit them, it's also good foreign policy that improves security and prosperity at home," the letter said.

While the debate is just getting warmed up, people are voting with their feet. Despite the cost and complexity of doing so, the number of US citizens renouncing their citizenship has spiked in recent years, with FATCA and US tax law in general getting much of the blame.

Perhaps Trump doesn't need that executive order after all. An increase in the IRS enforcement budget might do the trick. *Paul has been a Washington-based business journalist since 1976. He welcomes your comments at merrion@mlex.com.*

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