Group Nears Finish Line in Scoring Residency-Based Taxation

by Andrew Velarde

Scoring of a proposal to shift individuals toward residency-based taxation (RBT) is nearing completion, according to counsel for American Citizens Abroad, and the group is confident the score will achieve the revenue neutrality necessary to catapult the proposal into the tax reform conversation.

"The key to this is to have a really good baseline picture of what's out there in the world and what the numbers are. There was not a good baseline for taxing Americans overseas. You cannot go waltzing into this unless you have [that] baseline," Charles M. Bruce of Bonnard Lawson, legal counsel for the nonpartisan group, told Tax Analysts. "The old numbers make the exercise look harder than it really is. It's not as big a hurdle as you'd think," he said about reaching revenue neutrality.

Having the baseline would go a long way to dispelling the significant amount of "misinformation out there," according to Marylouise Serrato, executive director of Americans Citizens Abroad, who said she was confident the group's numbers would come in time to inform the tax reform debate and would show that many individuals fall below income exclusion thresholds provided for under the code.

The group has engaged District Economics Group LLC for the scoring, which is about 95 percent done, Bruce said. Serrato said she has met with the Joint Committee on Taxation twice in the last year, and Bruce noted the group met with Treasury the week of October 16. Meetings with the offices of congressional taxwriters have also been a focus for advancing the proposal, Serrato added.

"There's certainly interest in the issue," Serrato said about her meetings with lawmakers. "Everything has been positive. They get it; they understand why it is needed, so it is all good news."

House Ways and Means Committee Chair Kevin Brady, R-Texas, said October 25 that Congress is considering RBT.

9 Million Living Abroad

With much of the international tax reform discussion focusing on corporations, far less time and attention have been given to applying the international tax to individuals, though the affected population could be substantial. The State Department estimates that there are 9 million citizens living abroad. Under U.S. law, Americans residing overseas are taxed on a worldwide basis, subject to some exclusions. Under section 911, citizens and resident aliens abroad can qualify for exclusions from taxable income on foreign-earned income up to $102,100 and for some housing costs if their tax home is in a foreign country.

Bruce argued that RBT would be easy to drop in alongside other reform proposals because it "didn't come close" to the difficulties of changing subpart F rules or moving to territoriality for corporations.

"Traditionally, when they work on these rules for corporations, at some point somebody looks up and says, 'Ah, by the way, what are we doing for individuals?'" Bruce said. "Then they will ask if this will muddy the waters for what we are doing for corporations and they'll realize no. [Corporate reform] is cutting from the neck all the way down the body. RBT is just dealing with an ankle," he added.

A primary strength behind RBT is the surprising agreement found across the political spectrum for the proposal, Bruce said. Both Grover Norquist's Americans for Tax Reform and Democrats Abroad have argued that tax reform presents a good opportunity to advance RBT.

Toggle Switches

American Citizens Abroad has been advocating RBT for several years. In December 2016 the group put forth its "vanilla approach" to move away from citizen-based taxation, which it emphasized was not a proposal per se, but a written description and side-by-side comparison of current law and RBT.

The group has called for a repeal of section 911 and, in its stead, subjecting U.S. citizens and resident aliens to tax only on U.S.-source income and income effectively connected with a U.S. trade or business. Individuals with a tax home in a foreign country for the last five years (aging test) would need to apply for a departure certificate. Upon departure, they would be subject to a departure tax, similar to expatriated individuals under sections 877 and 877A, except the $2 million threshold to trigger the exit tax, which treats assets as sold at fair market value, would be raised to $5 million. The proposal exempts from the exit tax tax-compliant individuals who have met the residency test for the last three years before enactment under a grandfather rule. Antiabuse rules hold gain on the sale of securities within two years of departure as taxable.

The group has since tweaked and added to its approach, including recent changes made in September that provide for taxing Social Security benefits, as well as early withdrawals and minimum distributions from retirement accounts, as U.S.-source income. The new approach also includes special rules for short-term overseas employment, under which qualifying individuals can make a one-time election for section 911 treatment for five years.

Important to achieving revenue neutrality may be a small handful of "toggle switches" that can be adjusted in the approach, according to Bruce. Among those provisions are the aging rule, section 911 repeal, and the threshold for the departure tax. Also under consideration is whether to disallow individuals residing in a tax haven from claiming RBT.

Giving Treasury the authority to add to the list of eligible RBT countries jurisdictions where it is important to have Americans present could be one way to address tax havens, Bruce said. That potential proposal might exclude some Caribbean nations but include Arab Gulf states with a significant contractor presence, he added.

"While [American Citizens Abroad] and other groups are focused on the numbers and options for crafting a proposal, JCT and Treasury will set what the revenue estimates are, and members will decide what the legislative provisions should look like," Serrato said. ■