



AMERICAN CITIZENS ABROAD

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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Submitted via www.regulations.gov

Submission by American Citizens Abroad, Inc.

Subject: Treasury's proposed regulations relating to section 965, as enacted by the Tax Cuts and Jobs Act of 2017

These comments are submitted by American Citizens Abroad, Inc. (ACA). They are made on behalf of its members and the estimated 9 million Americans abroad.¹ Of the Americans abroad, many own or operate businesses through entities that can be characterized as foreign controlled corporations for US tax purposes, and, therefore, they will be affected by the subject regulations.

On August 9, the Treasury Department published proposed regulations implementing Internal Revenue Code section 965, as amended by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. (REG-104226-18.) Section 965 levies a transition tax on post-1986 untaxed foreign earnings of specified foreign corporations owned by US shareholders by deeming those earnings to be repatriated. The new statutory provision and these section 965 proposed regulations affect almost every American abroad with direct or indirect ownership interests in certain foreign corporations. Broadly speaking, these are foreign corporations controlled by these U.S. individuals. The corporations can be big or small. The individuals likewise can be wealthy or "middle-class" or relatively modest in means.

The purpose of these comments is to request that the Treasury Department provide a *de minimis* rule that takes out from under the requirements of section 965 all small taxpayers living abroad. These are US individuals who own directly or indirectly foreign corporations. Alternatively, these individuals might be permitted to treat small CFCs as disregarded entities and to elect to do so retroactively. We also make several specific comments in response to the list of specifically requested comments, which appears in the proposed regulations. Additionally, we dispute the finding under Regulatory Flexibility Analysis that the regulations will not have a significant economic impact on a substantial number of small entities and, therefore, that an initial regulatory flexibility analysis is not required.

We are mindful that the transition tax, in reality, is a one-time phenomenon whose effects, setting aside a possible election to spread out payments, will disappear quickly.

Americans abroad were overlooked in the recent "head over heels" rush to enact some form of "tax reform". In the process, oversights were committed. The tax benefit in the form of a version of territorial taxation for some international businesses was simply not considered in the context of Americans abroad. Transition tax, GILTI, the pass-through deduction, all of these flew by without thought being given to how

¹ ACA believes that the number of US residents residing outside the US is more on the order of 5.1 million. A significant number of these, approximately 1.3 million, are affiliated with the federal government. The Office of Tax Analysis and the Joint Committee on Taxation will have better information, as they can refer to tax return information and other non-public sources. ACA's sister organization, American Citizens Abroad Global Foundation, with its contractor, District Economics Group, has studied this subject. https://www.americansabroad.org/media/files/files/dc1e1c4e/DEG_short_memo_on_RBT_proposal_11.06.2017.pdf



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they sat with Americans abroad. Americans abroad get almost none of the benefits but all of the detriments – including detrimental transition tax treatment, which is the subject of this submission.

This habit of overlooking Americans abroad and their circumstances, which are different from those of their compatriots residing in one of the States or the District of Columbia, should not be repeated in these regulations. For example, while it is unusual for someone residing in the United States to have anything to do with a business entity outside the US, it is an everyday fact of life for an American abroad to own or operate a “foreign” business, and this reality should not be passed by.

ON BEHALF OF AMERICANS ABROAD, WE REQUEST THAT TREASURY DEPARTMENT MAKE CHANGES IN THE SECTION 965 PROPOSED REGULATIONS, CHANGES WHICH RECOGNIZE THE FACTS OF LIFE OF THESE INDIVIDUAL.

BACKGROUND

The transition tax applies to individuals as well as corporations, and these individuals might be US citizens resident abroad.

The proposed regulations state that section 965 is clearly made to apply to all United States shareholders, including individuals as well as corporations. As noted in the proposed regulations, the Conference Report states: “*In contrast to the participation exemption deduction [in section 245A] available only to domestic corporations that are U.S. shareholders under subpart F, the transition rule applies to all U.S. shareholders.*” H.R. Rep. No. 115-466, at 606 (2017) (Conf. Rep.).

The new dividends-received deduction in new section 245A benefits US corporate shareholders but not US individual shareholders including individuals residing abroad.

New section 245A provides US (domestic) corporations a 100% dividends-received deduction for dividends distributed by a controlled foreign corporation (CFC). In order to transition to the new territorial-like system, the Act imposes a one-time deemed repatriation tax, payable, if elected, over 8 years, on unremitted earnings and profits at a rate of 8 percent for illiquid assets and 15.5 percent for cash and cash equivalents. (New sections 78, 904, 907 and 965.)

The dividends-received deduction, as noted, is available only to US corporations that are shareholders in the CFC. The deduction is not available to individuals, nor is it available to foreign corporations, which, for example, are owned by US individuals, including individuals living abroad. However, the repatriation tax applies to everyone, not merely US corporations. Accordingly, an individual, for example, a US citizen residing abroad, who is a shareholder in a CFC, while not able to benefit from the 100% dividends received deduction, might be subject to the transition tax. This individual, it should be noted, might not have in hand the actual monies needed to pay this tax.

The transition tax will adversely affect, gravely, many Americans abroad.

It is very common for American individuals living and working in a foreign country to own a foreign company. He or she might have a small business that is owned and operated through an entity created under local foreign law but characterized as a corporation for US tax purposes. This might be done to comply with local rules that influence the decision to incorporate. It might be done to protect against all kinds of liabilities under local rules. Most Americans abroad who are “hit” by these new rules will not have “incorporated” with US taxes in mind. In fact, they will not have thought about all of the detailed rules and nuances governing characterization of entities for US tax purposes.



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The “downward attribution” rule is an additional kick in the head.

In TCJA, there is a new “downward attribution” rule. (New section 958(b) of the IRC.) This is a hypertechnical change to hypertechnical existing provisions. But for some Americans abroad it can be a disaster. An American residing, say, in Norway, owning and operating a restaurant, through a local company, together with a foreign family trust or estate, might suddenly find himself treated as a shareholder in a controlled foreign corporation and subject to the new rules. It will take months to figure out how these rules apply and to calculate the amount of tax owed. There is no *de minimis* rule to save small taxpayers from having to deal with this particular rule. The cost of complying – making the calculations and preparing and submitting the returns – could easily exceed the actual tax liability.

ACA is being inundated with complaints from Americans abroad about transition tax and related matters.

ACA has heard from small business owners, who were never “socking away” income offshore to avoid US taxation, about the life-changing effects the law is having on them and their businesses.² Many of these individuals have been setting aside profits in their foreign company simply because, rather than paying out profits to themselves, they are in effect financing future operations and perhaps future expansion. By nature, the business is “foreign”; it is situated and operates outside the US; all its employees live outside the US. There may be no connection with the US other than the fact that some or all of the shareholders are US citizens. These individuals reside in the foreign country and, in fact, might not travel to the US or if they do, do so infrequently. Some feel they will have to liquidate their businesses because the cost to calculate, and pay, the tax will bankrupt them.

AMEND THE PROPOSED REGULATIONS TO PROVIDE A *DE MINIMIS* RULE FOR AMERICANS ABROAD

A de minimis rule should be inserted into the regulations.

An immediate “fix” can be made by applying a *de minimis* rule to exempt small taxpayers living outside the US. This is a common-sense approach. The same type of approach was applied in the case of the filing of Forms 8938 (Statement of Specified Foreign Financial Assets) given the understanding by Treasury that certain US citizens by the very nature of their living overseas would have good reason to have foreign investment accounts above the threshold of individuals living in the United States. The same logic can be applied to taxpayers that reside abroad and own a CFC. Residency rules along the lines of those in section 911 (Citizens or residents of the United States living abroad) can be used. Since the rule would apply at the level of the individual taxpayer, not the entity, thresholds like those in the Form 8938 instructions can be applied. OTA’s data will disclose how many individuals will be saved from what many of ACA’s members view as a tax filing tsunami.

The rule in section 965(c)(3)(E) for non-corporate entities should not be applied to disregarded entities held by small taxpayers living outside the US.

An American abroad holding a foreign entity which is characterized as something other than a corporation for US tax purposes, does not have the transition tax problem. A similarly situated individual who holds a foreign entity which is characterized as a corporation for US tax purposes, is “hit” with the transition tax. A close look at the list of foreign entities classified as corporations for federal tax purposes incorporated in

² Not many individuals will have the ability themselves to submit comments on these regulations. What ACA has heard from individuals is similar to the comments submitted anonymously, dated October 4, 2018, which can be found at <https://www.regulations.gov/document?D=IRS-2018-0019-0088>.



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Form 8832 makes the point. In many of these jurisdictions, there are entities that are very similar to the ones listed, which are not treated as a “corporation”. Small taxpayers should be permitted to treat a foreign corporation, like the ones listed, as “disregarded” for purposes of the very quirky transition tax. Again, reference might be made to section 911 to determine residence and the Form 8938 instructions for “small”.

Small taxpayers should also be allowed to make the entity classification election (elect for the entity to be disregarded) retroactively.

Additional Points

Paperwork Reduction Act / Comments on specifically requested matters

With respect to the collection of information, the proposed regulations specifically request comments on a number of points. ACA’s comments as to some of these as follow. A copy of these comments is being sent to the Office of Management and Budget and a copy to the IRS Reports Clearance Officer, as directed in the proposed regulations.

1. Whether the proposed collection of information is necessary for the proper performance of the duties of the IRS, including whether the information will have practical utility.

Requirements to collect information are scattered throughout the regulations, generally in connection with making an election or claiming a favorable rule. Small taxpayers need to be able to do these things as much as large taxpayers. Even figuring out what information is required and how to go about ascertaining that information, is a high hurdle for small taxpayers. Recall, among other things, that the entity in question might not appear, in the first instance, to be a corporation. It probably was formed under foreign law and only after applying US tax concepts and definitions does it emerge as a corporation subject to CFC rules and now the transition tax rules. A US taxpayer might be expected to know something about corporate tax rules, the computation of taxable income, the computation of earnings and profits, and so forth. All these things might sound vaguely familiar. None of the details necessary to walk through these US tax filing steps, however, are going to appear in the everyday books and records and filings of the foreign corporation. Everything will have to be reconstituted and restated. Frequently, information will need to be translated because, annoyingly to some of us, countries like France, operate in French rather than English.

Small taxpayers residing abroad should be exempted from the transition tax and its information-collection provisions. If the result of imposition of the taxes a relatively small amount of tax, both the taxpayer and the Internal Revenue Service should be saved from this ordeal.

2. The accuracy of the estimated burden associated with the proposed collection of information (including underlying assumptions and methodology).

It is said that the estimated average annual burden per respondent (taxpayer) is five hours. In the history of proposed regulations, no doubt there have been some “far out” estimates. In our view, not meaning any disrespect, this may take the cake. Just briefly, raw information will have to be gathered and then reconstituted and restated in US tax terms. One cannot simply gather information without understanding what the rules are, what the requirements for gathering information are and where all of this is heading. Taxable income will need to be determined. Then earnings and profits will need to be determined. Then the special adjustments called for by section 965 will have to be made. Under the best of circumstances, we would guess – and it is only a guess – the figure for gathering



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information should be 50 hours, 10 times more than the figure proffered. And this does not include reading the statute, legislative history, proposed regulations (62 pages), various notices dealing with filing deadlines and extensions, and other such things.

3. How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology.

It is not possible to comment upon how the collection of information useful in the preparation of returns might be minimized. The software to assist in the preparation of tax returns for taxpayers residing abroad is expensive and not as comprehensive in all situations as might be hoped. Certainly, software applicable to Americans abroad with foreign corporations which are CFCs and which fall within the ambit of section 965 is nowhere near available. Our guess is that at some point it will become available and when it does the resulting work product will likely need to be modified “by hand” in many ways.

4. Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information.

Tax return preparation for Americans residing abroad is already, even in relatively straightforward cases, quite expensive. What would cost a taxpayer living and working and earning income only in the States, might cost the typical American abroad, especially one with involvements in a foreign corporation or partnership, several times more. The gathering of information is almost always done by the taxpayer, not the professional preparer.

ACA, since June 2014, has published online a directory of tax return preparers specializing in returns for nonresident Americans.³ This has proven to be very popular. Working with this population of return preparers, ACA has developed a very good insight into the subject. It's safe to say, preparation of tax returns for expats is already quite expensive. Tax law provisions, such as the transition tax, quickly jump this number to a significantly higher number.

It is also the case that new rules, like the transition tax, GILTI, pass-through deduction, etc., rules place a great deal of pressure on the return preparer population. Exposure to risks for these preparers has grown markedly, also, and in a not unrelated fashion, the population of return preparers is dwindling. Preparing tax returns for Americans abroad, most definitely, is not for the faint of heart.

Applicability of Regulatory Flexibility Act

The proposed regulations, under the section dealing with “Regulatory Flexibility Analysis” (RFA), state as follows.

The Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply because the regulations do not impose a collection of information on small entities. Any burden on small entities in these regulations stems from the collection of information requirements in proposed §§ 1.965-2(d)(2)(ii)(B), 1.965-2(f)(2)(iii)(B), 1.965-3(b)(2), 1.965-3(c)(3), 1.965-4(b)(2)(i), 1.965-7(b)(2), 1.965-7(b)(3)(iii)(B), 1.965-7(c)(2), 1.965-7(c)(3)(iv)(B), 1.965-7(c)(3)(v)(D), 1.965-7(c)(6)(i), 1.965-7(d)(3), 1.965-7(e)(2), 1.965-7(f)(5), and 1.965-8(c). It is hereby certified that these collection of information requirements will not have a significant economic impact on a substantial number of small entities. Accordingly, an initial

³ <http://acareturnpreparerdirectory.com/>. This Directory is being updated in light of TCJA and other developments.



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regulatory flexibility analysis is not required. This certification is based on several facts. First, the average burden is five hours, which is minimal, particularly in comparison to other regulatory requirements related to owning stock in a specified foreign corporation. Second, the requirements apply only if a taxpayer chooses to make an election or rely on a favorable rule. Third, the collections of information apply to the owners of specified foreign corporations. Because it takes significant resources and investment for a foreign business to be operated in corporate form by a United States person, specified foreign corporations will infrequently be small entities. Moreover, because the collection of information requirements apply to the owners of specified foreign corporations rather than the specified foreign corporations themselves, a specified foreign corporation that was a small entity would not be subject to the collections of information. Fourth, the collection of information requirements in this regulation apply primarily to persons that are United States shareholders of specified foreign corporations. The ownership of sufficient stock in specified foreign corporations in order to constitute a United States shareholder generally entails significant resources and investment, such that businesses that are United States shareholders are generally not small businesses. Pursuant to section 7805(f), this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

ACA's opinion differs here because, fundamentally, this does not take notice of the fact that many businesses owned by Americans abroad are affected. With Americans abroad, businesses are commonly owned by the individuals who happened to be US citizens. Whether the entity is a corporation, under US tax principles, or not is almost a matter of happenstance. The conclusion that the collection of information requirements in the regulations will not have significant economic impact on a substantial number of small entities ignores the reality that Americans abroad frequently own and operate businesses, often small businesses. An American chef, actually a dual national American and Norwegian, owning a restaurant in Bergen, Norway, might have paid little or no attention to the form of the entity, which, if it included this or that characteristic, would for US tax purposes be treated as an association taxable as a corporation. Omit a characteristic, such as anything cutting off personal liability for the owner, and the entity will not be treated as a corporation but something else, maybe a sole proprietorship or maybe a partnership if there are others involved. The point is there are many businesses, typically small businesses, owned by Americans abroad and whether they are technically, under US tax rules, characterized as a corporation is hard to say and jumps around on a case-by case basis. For sure, substantial numbers of small entities are affected.

As for the point that collections of information apply only to owners of specified foreign corporations, and “[b]ecause it takes significant resources and investment for foreign business to be operated in corporate form by United States person, specified foreign corporations will infrequently be small entities”, this demonstrates the problem nicely: Foreign corporations owned by Americans abroad exist in abundance. They are an everyday fact of life.

Similarly, as to the point “the collection of information requirements in this regulation apply primarily to persons that are United States shareholders of specified foreign corporations. The ownership of sufficient stock in specified foreign corporations in order to constitute a United States shareholder generally entails significant resources and investment such that businesses that are United States shareholders are generally not small corporations.” This misses the point that in the Americans abroad community many individuals own small businesses directly or sometimes through entities.

Treasury Department should revisit the issue whether the Regulatory Flexibility Act applies. In doing so, it should recognize that large numbers of American taxpayers abroad are affected by the regulations. Many of these are small entities and their owners. The proposed regulations will have significant economic effects for them.



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The Office of Tax Analysis should be asked to identify how many Americans abroad own controlled foreign corporations and how many of these fall in the category of “small entities” for purposes of RFA.

ACA appreciates the opportunity to make these comments, and it would be pleased to field additional questions.

[ACA requests that a public hearing be scheduled.](#) For additional information or anything else relating to these comments, please contact Marylouise Serrato, info@americansabroad.org.

Respectfully submitted,

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ACA is the only non-partisan, non-profit, advocacy organization representing Americans living and working overseas headquartered in Washington, DC. It is a leading authority on issues affecting Americans living and working overseas with a 40-year history of advocacy work. See: www.americansabroad.org.