United States

Group Pursuing Score of Residency Taxation to Prove Neutrality

American Citizens Abroad plans to engage an independent economic consulting firm specializing in tax policy to score its residence-based taxation (RBT) baseline approach for U.S. citizens and resident aliens to prove its revenue neutrality, the group's legal counsel told Tax Analysts March 22.

''It's got to be two things. It's got to be revenue neutral and it has to be tight on abuse,'' Charles M. Bruce of Bonnard Lawson and legal counsel for the group said about the group's middle-of-the road approach. ''It is absolutely the case for a significant number of these people that [what motivates them] is saving with reporting and not being worried about the system, which is scary to them. And a lot of them are not being driven by the taxes,'' he said.

Bruce said that the nonprofit was taking a somewhat novel approach to tackling the cost of the revenue estimate by engaging in crowd funding. The organization, which has raised a significant amount of the money from outreach to its members and other groups, is looking to engage District Economics Group LLC for the scoring, Bruce said, and expects the work to be completed in several months. He added he is confident that RBT can achieve revenue neutrality in what represents a starting point to replace the current citizenship-based taxation model.

According to FAQs on its website American Citizens Abroad looks to revenue neutrality as the best way forward in a climate of tax reform uncertainty. With difficulties in quantifying arguments that RBT enhances competitiveness, if a proposal were to result in lost revenue, resident U.S. citizens might argue that they were in effect subsidizing tax relief for those abroad, the group states.

''Why fight uphill and have to defend a loss of revenue when you can present a proposal that is revenue neutral?'' American Citizens Abroad argues.

The group introduced the basics of its approach in December, proposing that individuals who move to an RBT system be subject to a departure tax provision. That provision would anchor itself to the thresholds under section 877, except it would set the net worth floor at $5 million and exclude U.S. real estate subject to the Foreign Investment Real Property Tax Act of 1980. To prevent abuse, the approach would require taxation of gain from the sale of securities for two years after departure. Another provision would prevent individuals from removing themselves from U.S. tax status, realizing income, then subsequently becoming subject to U.S. tax rules.

Although not outlined in the approach, further emphasizing the need for strong antiabuse measures, Bruce recalled the bill titled the Expatriation Prevention by Abolishing Tax-Related Incentives for Offshore Tenancy Act, proposed by Sens. Charles E. Schumer, D-N.Y., and Robert P. Casey Jr., D-Pa., in 2012. It would have banned expatriates who renounced citizenship for tax purposes in the previous 10 years from reentering the United States if they continued to avoid taxes. It also required a new 30 percent capital gains tax on any investments the taxpayer may make in the United States. The bill followed the disclosure that Facebook Inc. investor Eduardo Saverin relinquished his U.S. citizenship before Facebook's initial public offering.

Under RBT, the estate of a nonresident American would be taxed only on U.S. property in excess of $60,000, similar to a nonresident alien. The approach also would have a grandfather rule for Americans who resided outside the United States for the last three years for estate and gift tax purposes. Section 911, applying exclusions from income for foreign earned income (currently $102,100) and housing costs, would be repealed.

Bruce noted that current section 911 exclusion rules help large corporate exporters, because they are often the entities that pay U.S. tax bills for U.S. employees working overseas. He argued that given its simplicity, an RBT system might also help smaller exporters, because those entities are less likely to hire accounting firms to handle the tax returns of their overseas employees.

Notable changes to the group's approach since it was introduced include a call for a same-country exemption from the Foreign Account Tax Compliance Act, following Treasury's decision not to implement such an exception in its final rules (T.D. 9809). The proposal also eliminates reporting on Form 8938, ''Statement of Specified Foreign Financial Assets,'' on information currently listed in foreign bank account reports. The FAQs also contemplate phase-in as well as grandfather rules for individuals living overseas for a specified period that would make them automatically eligible for RBT treatment without any other action.

Potential Revenue Raisers

According to the State Department, an estimated 9 million citizens lived abroad in 2016. Putting tax cost aside, the complexity of tax returns and reporting may motivate many of them to seek to move to the RBT system, Bruce argued.

''A very significant incentive is the paperwork,'' Bruce said, contrasting the U.S. tax return with the United Kingdom's. ''The U.K. is not a silly jurisdiction and the U.K. paperwork is much, much simpler and easier to do, And not only is [the U.S. return] complicated, it's scary,'' Bruce added. He argued that many taxpayers have a strong fear, irrational or not, of an IRS audit.

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Bruce said many individuals may not save significant tax amounts under RBT, given current exclusions under the foreign earned income exclusion and the housing allowance, the elimination of which could raise revenue under the proposal. RBT could also raise revenue if the system limited foreign tax credits, Bruce said.

''If you are in a high-tax jurisdiction — U.K., France, Germany, most of Europe — you're not paying any U.S. tax anyway because you are covering it with the foreign tax credit,'' Bruce said. The departure tax, FIRPTA, withholding taxes, and estate taxation under nonresident alien rules may also raise revenue, Bruce surmised. Transition rules might also be adjusted, if necessary, to reach revenue neutrality, he added. The group is willing to pivot its approach generally as needed, Bruce said.

According to the IRS Statistics of Income, tax returns from 2011 filed with Form 2555, ''Foreign Earned Income,'' reported foreign earned income exclusions of $28.1 billion and foreign tax credits of $5.7 billion. Total income tax reported on those returns was $5 billion. Of the $54 billion in total foreign earned income, the large majority was earned in Asia and Europe ($24.9 billion and $14.4 billion, respectively). The housing exclusion amounted to $1.6 billion, with Asia and Europe accounting for $923 million and $447 million, respectively.

While the future of the estate tax is cloudy, given that the exclusion is much lower for a nonresident alien than for a citizen, many U.S. citizens who would not currently pay much estate tax might pay more under an RBT system, Bruce argued. Again, he emphasized the importance of a grandfather clause exempting some individuals who may have lived their whole lives overseas.

Generally, a nonresident alien's U.S.-situated assets that are subject to tax include American real estate, tangible personal property, and securities of U.S. companies. However, estate tax treaties may limit the type of asset considered U.S.-situated.

Potential Political Allies

American Citizens Abroad has potential allies in D.C. whose interests have previously aligned with the group. Most notable is the bipartisan Americans Abroad Caucus, whose members include U.S. Rep. Carolyn B. Maloney, D-N.Y., co-chair and co-founder of the group, and before his departure to head the Office of Management and Budget, former co-chair Mick Mulvaney. He earlier endorsed a proposal for a bona fide residence exemption from FATCA. Members of the caucus have been American Citizens Abroad's primary target for gathering congressional support of the RBT approach, Bruce said. He added his group has received a good reception from the caucus and the RBT's prospects are improved if it can be presented as revenue neutral.

Maloney's office did not respond to a request for comment.

''The tax-writing and other committees and member offices that ACA met with are all familiar with ACA's approach to residency-based taxation of Americans overseas, and meetings in these offices lead us to believe that legislation making this change is eminently doable,'' the organization's executive director, Marylouise Serrato, said in a press release March 21. Serrato said the House Republican tax reform blueprint, which seeks to move to a territorial system for corporations and establish a destination-based cash flow tax system, leaves open the door for a change for individuals as well.

The language of the House GOP's blueprint under consideration falls short of a full endorsement of individual RBT, however, stating that it ''will consider the appropriate treatment of individuals living and working abroad.'' But the fate of RBT may not rise and fall solely with a plan that has both fierce support and opposition in the business community. Senate Finance Committee Chair Orrin G. Hatch, R-Utah, included stronger language in his 2014 corporate integration tax reform proposal, which called for reconsideration of the taxing of nonresident citizens. That plan is purported to be revenue neutral itself, and is awaiting possible inclusion in a larger reform effort.

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