American Citizens Abroad
Explanation*

Legislation introduced by Congressman Buyer (D-Va, 8th District) calls for the creation of a short form tax return to simplify the return process for certain taxpayers living abroad (section 2 of the bill) and expands the foreign earned income exclusion under section 911 (section 3 of the bill). At the time of this writing, no technical explanation of the bill or revenue estimate has been released.

Section 2 instructs the Secretary of Treasury or the IRS to create a form for use by individuals to file the federal income tax return. (An individual might be a US citizen or alien individual treated as a resident alien for US tax purposes.) This bill provision is not an amendment to the Code but rather an instruction to Treasury. The form "shall be as similar as practicable to Form 1040-EZ as it existed in 2017". (Form 1040-EZ was eliminated as part of the Tax Cuts and Jobs Act. For tax year 2018 and later, individuals no longer use Form 1040-EZ, but instead use Form 1040 or Form 1040-SR. Form 1040-EZ (Income Tax Return for Single and Joint Filers with No Dependents) 2017, in effect, is the intended model for the new "short form" for certain Americans abroad. See https://www.irs.gov/pub/irs-prior/f1040ez--2017.pdf.

The new form will allow an individual:

To demonstrate that he or she is a nonresident for purposes of the substantial presence test in section 7701 (b)(3). (This provision seems most useful for any alien individual wishing to establish that he or she is "non-resident" and, therefore, not subject to US income tax.)

To declare foreign earned income for purposes of the section 911 exclusion. (Apparently this relates only to foreign earned income, not housing expenses, which are also dealt with in section 911.)

To characterize income based on source, including, but apparently not exclusively, wages, contract income, foreign government benefits, pension and other retirement income, scholarships and fellowship grants, interest, dividends, and capital gains. Characterizing, for example, certain pension income as "foreign" would be favorable because it would place income under the expanded rules in amended section 911. Section 911, as amended by this legislation, would treat some income, which previously did not qualify for the foreign earned income exclusion, as excludable. See below.

To claim the standard deduction and, if applicable, the child tax credit and earned income tax credit.

To declare foreign taxes paid (and thus benefit from the foreign tax credit and deduction rules).

Declare United States source income from retirement, pension and Social Security benefits to be treated as resourced from treaty income where taxes been paid upon distribution. (Certain bilateral tax treaties allow a US citizen an additional credit for part of the tax imposed by the other country on US source income. This is separate from, and in addition to, the foreign tax credit for foreign taxes paid or accrued on foreign source income. If a sourcing rule in an applicable income tax treaty treats U.S. source income as foreign source, and the taxpayer elects to apply the treaty, he or she, in the foreign tax credit calculation, can include that income under the category "Certain Income Re-sourced By Treaty". The income can be treated as foreign source to the extent provided in the treaty. The taxpayer must compute a separate foreign tax credit limitation for any such income for which he or she claims benefits

under the treaty, using a separate Form 1116, Foreign Tax Credit, for each amount of resourced income from a treaty country. See Internal Revenue Code sections 865(h), 904(d)(6), and 904(h)(10) and the regulations under those sections (including Regulation section 1.904-5(m)(7)) for any grouping rules and exceptions. This provision in the Beyer bill makes this favorable approach more widely available. While the new "short form" may be short, the instructions explaining the workings of this rule may not be so short. A Joint Committee on Taxation Technical Explanation of the Buyer bill would be helpful. Likewise, Treasury regulations following enactment will be important and necessary.)

Section 2 of the bill amends section 911 (US citizens or residents of the US living abroad – exclusion of certain income and special treatment of housing expenses) as follows:

By putting back in the definition of foreign earned income amounts received as a pension or annuity. Under current law, these are specifically excluded.

By expanding the definition of "foreign earned income" to include not only services performed by the taxpayer but also benefits received by such taxpayer. An indication of the meaning of "benefits" follows immediately.

By expanding the meaning of "earned income" to include not only wages, salaries, professional fees, and other amounts received as compensation for personal services, but also pensions, distributions from retirement funds, or payments received with respect to disability, unemployment, family medical leave, or childcare.

Changes in the definitions of "foreign earned income" and "earned income" in section 911, as amended, may affect other provisions of the Code, and Treasury and the IRS will no doubt pay close attention to this.

The effective date of provisions in both section 2 and 3 is taxable years beginning after date of enactment.

As of today, there are no estimates of the revenue effects of this legislation. There will be a significant revenue effect because additional types of income become excludable, i.e., not taxable. It should be noted, among other things, that US Social Security payments are not simply excluded from tax.

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*This explanation was prepared by Charles M Bruce. He is solely responsible for any misstatements or mistakes.