



AMERICAN CITIZENS ABROAD

EDUCATE, ADVOCATE AND INFORM

Residency-Based Taxation

Side-By-Side Analysis: Citizenship-Based Taxation (Current Law) | ACA's Residency-Based Taxation Proposal

1 December 2016

Current Law – Citizenship-Based Taxation (“Current Law”)	Residency-Based Taxation – ACA Proposal
Taxpayers/Affected Individuals	Taxpayers/Affected Individuals
<p>For federal income tax purposes, US citizens and resident aliens generally taxed on worldwide income regardless of source of income or other factors.</p> <p>Citizenship defined by nationality laws. “Resident alien” defined by income tax rules in section 7701(b) (physical presence and “green card” test).</p> <p>Non-US citizens and non-resident alien individuals subject to US tax only on certain US source income and income effectively-connected with a US trade or business. Income from US real property generally taxed under Foreign Investment in Real Property Tax (FIRPTA) rules (§897).</p> <p>No provision tied to “tax haven” status applies individuals.</p>	<p>For federal income tax purposes, US citizens and resident aliens, including “green card” holders, (non-resident taxpayers) taxed on residency basis, i.e., generally only on US source income.</p> <p>Same as current law.</p> <p>Non-resident taxpayers are subject to taxation the same as non-resident alien individuals. Normal sourcing rules in the Internal Revenue Code and bilateral income tax treaties, including provisions for reduced withholding tax rates, apply. §§861-865. US source income is taxed under rules applicable to non-resident aliens. §§871-898. Likewise, effectively connected income (ECI) (§871(b)) and Foreign Investment in Real Property Tax (FIRPTA) rules (§897) are applicable.</p> <p>Individuals can opt out by not applying for a Departure Certificate (see below).</p> <p>Residency-based taxation is not available to members of the armed services and diplomatic corps.</p> <p>Special definitions and other rules in bilateral income tax treaties apply to non-resident taxpayers that otherwise qualify under the treaty’s provisions. “Savings clause” does not apply.</p> <p>No provision.</p> <p>Residency in a “sanctioned country” does not qualify for purposes of residency-based taxation rules.</p>



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM

	<p>Income from a “sanctioned country” does not qualify for residency-based tax treatment.</p> <p>In order to qualify for residency-based taxation, same residency test as current section 911, except individual must have met the test for the most recent 5 taxable years prior to the year of claiming non-resident American status.</p>
<p>Special Rules for Citizens or Residents Abroad</p>	<p>Special Rules for Citizens or Residents Abroad</p>
<p>Section 911</p>	<p>Section 911</p>
<p>US citizens and resident aliens can qualify for exclusion from taxable income comprised of eligible foreign earned income exclusion and a housing cost amount under section 911.</p> <p>In order to qualify for section 911, residency test must be met. Individual’s “tax home” must be in a foreign country and the individual must be a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year or be present in a foreign country for at least 330 full days during a period of 12 consecutive months. Section 911.</p> <p>Foreign earned income exclusion annual amount is currently \$100,800 (for 2015). Housing cost amount in general equals the excess of housing expenses over a figure tied to 16% of the salary of a US Government employee (Grade GS-14).</p> <p>Housing cost amount can be increased for certain locations with high housing costs compared to the US. E.g., Notice 2014-29, 2014-18 IRB 991.</p> <p>Foreign earned income and housing expenses do not include income or expenses related to a “sanctioned country” (essentially a country that has been designated as repeatedly providing support for acts of international terrorism, one as to which the US has severed or does not conduct diplomatic relations, etc.).</p>	<p>Section 911 (including both foreign earned income exclusion and a housing cost amount) is repealed.</p> <p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p>



AMERICAN CITIZENS ABROAD

EDUCATE, ADVOCATE AND INFORM

No requirement that to qualify for foreign earned income exclusion, individual must be subject to income tax in another country.	Section 911 is repealed.
Special Rules for Specified Short-Turn Overseas Employment Contracts	Special Rules for Specified Short-Turn Overseas Employment Contracts
No provisions.	No provision.
Estate and Gift Taxation	Estate and Gift Taxation
<p>For federal gift and estate tax purposes, US citizens and residents subject to gift and estate tax with respect to worldwide assets. Estates with combined gross assets and prior taxable gifts of \$5,490,000 or less (2017 figure) are not required to file an estate tax return. Citizenship defined by nationality laws. "Resident" generally defined by estate tax rules in regulations (Reg. §20.0-1(b) (essentially domicile, following common law principles)).</p> <p>Non-residents' estates must file an estate tax return if the fair market value at death of the decedent's U.S.-situated assets exceeds \$60,000. Substantial lifetime gifts of U.S. property by decedent can reduce this figure.</p>	<p>Estate of non-resident American taxed as estate of non-resident alien (i.e., taxed only on US property) not subject to US estate tax.</p> <p>Same as current law (\$60,000 threshold).</p> <p>In order to qualify, decedent must have qualified as a non-resident American for 3 years prior to date of death.</p> <p>Non-resident American taxed the same as non-resident alien individual under current gift tax rules. Donor must have qualified as a non-resident American for 3 years prior to date of gift.</p> <p>American resident outside the US for most recent three calendar years prior to year of enactment is treated as "non-resident".</p>
FATCA; Payroll Taxes	FATCA; Payroll Taxes
Filing Requirement	Filing Requirement
Must file a Form 1040 and attach a Form 2555 (Foreign Earned Income).	Qualifying individuals wishing to be taxed on a residency-basis are required to apply to the IRS for a Departure Certificate. Non-resident taxpayer status commences with date of Departure Certificate.



AMERICAN CITIZENS ABROAD

EDUCATE, ADVOCATE AND INFORM

	<p>Year of issuance of Departure Certificate is a split year, and individual files a dual return (Form 1040NR and Form 1040).</p> <p>Non-resident taxpayers with effectively connected income file Form 1040NR.</p> <p>No provision for reporting change of residence from one country to another.</p> <p>Any individual claiming Residency-Based Taxation must file an annual certification stating under oath that he/she is a US citizen or resident alien, fulfils the residency requirements for the taxable year (including the 5-year rule, above), and does not have income related to a “restricted country”. Failure to file annual certification terminates status as non-resident American.</p>
<p>Departure Tax Provision</p>	<p>Departure Tax Provision</p>
<p>A US citizen who renounces or a long-term US resident gives up residence status and who meets certain tests is treated as a “covered expatriate”. All property of such individual is treated as sold on the day before the expatriation date for its fair market value. The first \$600,000 (adjusted for cost-of-living increases; \$680,000 for 2014) is excluded. Sections 877 & 877-A.</p> <p>Threshold tests are individual has average annual net income tax of greater than \$124,000 (adjusted for cost-of-living increases; \$157,000 for 2014) over most recent 5 years or a net worth of \$2,000,000 or individual fails to certify under penalty of perjury that he or she is tax compliant for the 5 preceding taxable years.</p>	<p>Individuals obtaining a Departure Certificate and meeting the threshold test of current section 877 (Expatriation to avoid tax) are subject to tax on income as if property was sold on the day before the date of the Departure Certificate.</p> <p>Threshold tests are the same as those in section 877, except \$2 million or more figure in section 877(a)(2)(B) increases to \$5 million and US real estate subject to FIRPTA rules is excluded. Rules similar to those in sections 877 and 877A applicable to pensions and other forms of deferred compensation apply.</p> <p>US real estate subject to FIRPTA rules is excluded.</p> <p>Special Rule for Individuals Residing Abroad. Individuals meeting the residency test for residency-based taxation for at least 3 years prior to date of enactment of these rules and who certify under penalty of perjury that they have been tax compliant, shall not be subject to the Departure Tax.</p>



AMERICAN CITIZENS ABROAD

EDUCATE, ADVOCATE AND INFORM

<p>Bequests and gifts to US persons from “covered expatriate” are taxed to recipient at highest estate tax or gift tax rate.</p> <p>State Department fee of \$2,350 charged for renunciation.</p>	<p>No provision. Non-resident American is not treated as a “US person”.</p> <p>One-time IRS User Fee of \$5,000 for Departure Certificate. Individuals qualifying for the special 3-year rule for individuals residing abroad, above, are not subject to this User Fee.</p>
<p>Effective Date; Transition Rules</p>	<p>Effective Date; Transition Rules</p> <p>In first year that individual holds a Departure Certificate, days spent in the US do not count for determining status as resident.</p> <p>Beginning date for residency-based tax status is date of issuance; it cannot be retroactive to an earlier date.</p> <p>Residency-based taxation, in effect, may be elected for a taxable year by an eligible individual by obtaining a Departure Certificate. Status as a non-resident American remains in effect so long as the individual qualifies and files annual certification that he/she qualifies, until the individual files with the IRS a request for termination of election and such request is approved.</p> <p>Effective for taxable years following date of enactment.</p> <p>If individual has fulfilled applicable requirements, he/she can immediately claim residency-based tax treatment for any taxable year following the effective date. Such treatment cannot be claimed for past open years.</p>
<p>Anti-Abuse Rules</p>	<p>Anti-Abuse Rules</p>
	<p>Gain from sale or disposition of securities for a 2-year period following issuance of a Departure Certificate remains taxable as under current law, regardless whether linked to prior employment in the US. Thus, if an individual residing in the US changes moves abroad (changes residence to a foreign residence) and sells or disposes of securities within 2 years of obtaining a Departure Certificate, gain will remain subject to US tax.</p>



AMERICAN CITIZENS ABROAD

EDUCATE, ADVOCATE AND INFORM

	<p>Issuance of a Departure Certificate requires proof that individual is a resident of a foreign country and is subject to taxation in that country on the same basis as others who are residents there.</p> <p>Issuance of a departure certificate requires proof of payment of all US income tax liabilities.</p> <p>Individuals not eligible for the special rule for individuals residing abroad, above, would be subject to the Departure Tax, whether or not they are tax-compliant. The date of departure for such individuals is the subsequent date of issuance of the Certificate.</p> <p>If an individual who was a non-resident American for any of the prior five years and was a resident American for any year prior to that period, and again becomes a resident American, then he or she shall be treated as a resident American for each of the prior five years. Otherwise, a returning Non-Resident American will be treated the same as a non-resident alien who becomes a resident alien for US tax purposes.</p>
<p>FBAR Filing Requirement</p>	<p>FBAR Filing Requirement</p>
<p>US persons, including individuals, companies, partnerships, trust, estates, etc., are required to file annually Foreign Bank Account Reports if they meet certain threshold tests relating to ownership and “signature power” and size of the account. Individual includes US citizen or resident alien as defined in section 7701(b).</p>	<p>Same as current law.</p>

*The principal draftsman of the comparative chart is Charles M. Bruce, Legal Counsel American Citizens Abroad, Inc. He is also Counsel at Bonnard Lawson-Lausanne. He is solely responsible for any errors. Thanks go to all members of ACA Executive Committee and retired Director Jackie Bugnion.