TESTIMONY OF AMERICAN CITIZENS ABROAD

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My name is Marylouise Serrato. I am the Executive Director of American Citizens Abroad, Inc. (“ACA”) an exempt section 501(c)(4) organization. Its sister organization is American Citizens Abroad Global Foundation, an exempt section 501(c)(3) organization. Together, they represent the interests of Americans living abroad.

It’s frequently said that there are around 9 million Americans living abroad. ACA believes this number is closer to 5.1 million, after making a number of adjustments, including one for approximately 1.3 million individuals affiliated with the federal government. Treasury Department’s Office of Tax Analysis and the Joint Committee on Taxation will have their own estimates as they can access tax return information and other non-public sources not available to ACA.

ACA is pleased to be able to present its views today.

ACA is very familiar with the situation, including the tax treatment, of Americans abroad, having dealt with this subject for over 40 years. Of interest might be the fact that for over 4 years, ACA has published an online directory of US tax return preparers servicing Americans abroad. Also, last year, in the run-up to tax reform, ACA Foundation produced baseline data of Americans abroad and an analysis of an approach that would replace citizenship-based taxation, the approach currently in the tax code, with residency-based taxation. This analysis, which was the first of its type and most comprehensive, was funded by the foundation and conducted by District Economics Group.

Work on this study gave ACA a good feeling for the numbers, that is, how many American taxpayers there are abroad, number of returns filed by them, income profile of overseas filers, and other key information.

ACA, we believe, is uniquely positioned to make several pointed remarks about the subject proposed regulations.

I won’t belabor points made in our comments on the regulations to the effect that section 965 is an enormous injustice because American individuals abroad don’t get the benefit of the dividends-received deduction but nonetheless are hit with the detriment of the transition tax. And this was done in the context of tax reform with no thought given to the impact on American taxpayers abroad.

Moving to the topics of the day: –

First, TREASURY DEPARTMENT AND THE IRS SHOULD INSERT A DE MINIMIS RULE INTO THE REGULATIONS.

These proposed regulations affect almost every American living abroad with direct or indirect ownership interests in certain foreign corporations. Broadly speaking, these are foreign corporations controlled by these American individuals. These corporations can be big or small. The individuals can be wealthy or “middle-class” or relatively modest in means.

Many Americans abroad own and do business through what, for US tax purposes, are characterized as corporations. They are commonly organized under foreign law, which differs in many ways from, say, Delaware corporate law. The steps for organizing them are different. The people involved – often fiduciaries in civil law jurisdictions – and the documentation is different. Most importantly, the basic accounting is different. As American accountants practicing in London, Paris, Frankfurt, and elsewhere will tell you, it is not a simple trick to go from local accounting to US accounting to US tax accounting. And now with section 965 and these regulations, taxpayers will have to make additional modifications to go to what I'll call section 965 tax accounting.

It should be obvious to everyone that a *de minimis* rule is necessary to take out from under the workings of the regulations small taxpayers. There can be no justification for requiring an American owning and operating a restaurant in Bergen, Norway, with very little in the way of undistributed, non-previously-taxed post-1986 foreign earnings of the business, to calculate and pay the transition tax. If he doesn't comply, not only will he owe the tax but also penalties and interest. In the true sense of the word, this result is absurd.

As suggested in our comments on the regulations, the *de minimis* rule can run to citizens or residents living abroad and residency rules along the lines of those in section 911 can be utilized. The rule should apply at the level of the individual taxpayer, not the entity, so as to avoid forcing the individual to make entity-level calculations, which would defeat the purpose. Thresholds like those in the Form 8938 instructions can be applied to define what is "small".

When drafting the rule, Treasury can look over at the data available to the Office of Tax Analysis to gauge how many people will be taken out of the section 965 regime and how much tax is involved. ACA's guess –and without access to tax return data which is available to Treasury and Joint Committee on Taxation it can only be a guess – is that all or almost all small taxpayers abroad with controlled foreign corporations ("CFCs") can be taken out of the 965 regime and the tax cost will be little if anything. End of day, many of the small businesses in question are simply not terribly profitable.

If the Treasury Department believes it cannot write a simple, up-front *de minimis* rule because its hands are tied, then it can come at the problem from a different direction: Small taxpayers can be allowed to treat their foreign corporations as disregarded entities. There not being a corporation in place, section 965 would not apply. Affected taxpayers can be allowed to retroactively make the election.

Still another approach is set forth in the comments of the American Chamber of Commerce in Japan, where it is suggested that the transition tax be indefinitely postponed until the occurrence of a triggering event. This would be along the lines of the rules applicable to S corporations. ACA commends ACCJ for its thinking on this subject.

And if none of these fallbacks are possible, then the Treasury Department and the IRS should go back to the drafting board and come up with their own solution. No one knows the ins and outs of the regulations like the drafters of the regulations. Having the regulations apply to small taxpayers is a glaring problem that everyone knows exists. Treasury Department and the IRS must fix it.

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Parenthetically, I'll add that the IRS should be as interested in fixing this problem as anyone. I suspect it wants to avoid having to deal with and perhaps audit tens of thousands of small taxpayers wrestling with some of the most complicated provisions in the Internal Revenue Code. It would be a waste of valuable IRS talent to have to review and perhaps argue about this issue.

Second, skipping over the official estimated average annual burden per taxpayer, which is said, we think wrongly, to be 5 hours, we turn to Treasury's determination that the Regulatory Flexibility Act ("RFA") does not apply essentially because shareholders of foreign corporations are not small entities.

THE CONCLUSION STATED IN THE REGULATIONS THAT THE COLLECTION OF INFORMATION REQUIREMENTS WILL NOT HAVE SIGNIFICANT ECONOMIC IMPACT ON A SUBSTANTIAL NUMBER OF SMALL ENTITIES WE THINK IS WRONG. It ignores the reality that Americans abroad frequently own and operate businesses, often small businesses.

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: Treasury Department is not truly in touch with the reality of Americans abroad. 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 again misses the point that in the Americans abroad community many individuals own small businesses directly or sometimes through entities.

Stepping back, Treasury Department, in our view, is not well informed about the situation of Americans abroad. These regulations, in the eyes of tens of thousands of individuals living overseas, are maddeningly cavalier.

Treasury Department should assess, under the Regulatory Flexibility Act, the impact of these proposed regulations on "small entities," as defined in the act, including small entities abroad.

To do so, it will need to identify the population of these entities. Among other things, Treasury should determine how many Americans abroad own CFCs, what are the size of the assets inside these CFCs, what is the inventory of relevant accumulated earnings and profits. It is fundamentally wrong for the Treasury Department to write regulations without knowing who is affected and to what extent. This goes against the fundamental requirements of the RFA, including the requirement for analysis of the small entities to which the rules will apply and an estimate of their number. Treasury Department cannot conclude that the regulations will not have a significant economic impact on a substantial number of small entities without a good idea about who is being affected.

Again, thank you for this opportunity to testify.