

United States

Advocacy Group Offers Individual Residency-Based Tax Plan

American Citizens Abroad is calling for a move away from citizenship-based taxation to residency-based taxation for U.S. citizens and resident aliens, in a proposal put forth December 6.

The purpose of the six-page, side-by-side comparison between current law and provisions in the new proposal is to “promote constructive consideration of the subject” and to outline the details of a change that has only been discussed broadly.

“It is intended to lay out a middle-of-the-road version, which then can be examined and modified,” an accompanying press release states about its proposal to generally tax only U.S.-source income. “It will provide a starting point for developing revenue estimates on the cost of switching from citizenship-based to residency-based taxation. It is, in other words, a form of baseline approach to the subject.”

Under the proposal, resident alien status for tax purposes would continue to be defined by rules under section 7701(b) (physical presence test and green card test). The release states that American Citizens Abroad will be working with other organizations in the coming months to develop revenue estimates on its proposal.

In December 2014, noting that the U.S. was the only industrialized country that imposed citizenship-based taxation, Senate Finance Committee Chair Orrin G.

Hatch, R-Utah, released a tax reform report that called for a reconsideration of the taxing rules of nonresident citizens. The proposal did not flesh out details, although it said that a test would be needed to determine at what point a U.S. citizen is considered a nonresident, with potential factors for consideration being permanence and purpose of the stay abroad, residential ties to the United States, residential ties to the foreign country, and regularity and length of visits to the United States. It also left open the option for an exit tax on citizens considering nonresidency.

Although it does not mention residency-based tax for individuals as overtly, the House GOP tax reform blueprint released in June also leaves open the possibility of reform in that context, while more directly examining simplification of international tax rules for businesses as part of its move toward territorial taxation.

“In addition to these important reforms that will create a modern international tax system for businesses, the Committee on Ways and Means will consider the appropriate treatment of individuals living and working abroad in today’s globally integrated economy,” the blueprint states.

“We’re looking at what’s out there and the general chatter. Certainly, the discussion of territorial [tax], in particular for corporations, has been quite active,” American Citizens Abroad Executive Director Marylouise Serrato told Tax Analysts, noting her organization’s April submission to Ways and Means on its call for comments on tax reform. “Our purpose in issuing the comparative chart — everyone is talking territorial and residence-based [tax], and no one has really done the work and the thinking to say how would this apply to Americans overseas. It is quite a complex question.”

Serrato also emphasized that the proposal represents a starting point for discussion and that her organization welcomes revenue scoring, which to her knowledge has not been done on any similar proposal in the past. “Until we have an answer to exactly how residence-based would work and how you can apply it and what the revenue estimates are on such a proposal, we are just talking in theory. Saying you are going to go territorial, you are going to go residence, that’s fantastic, but you really now have to go ahead and do the work.”

Under the proposal, qualifying individuals wanting residency-based taxation would need to apply for a departure certificate with the IRS, at the cost of \$5,000, and subsequently file annual certifications on the continued fulfillment of the residency requirements.

The proposal states that individuals obtaining departure certificates would be subject to tax on income as if their property were sold and the same threshold tests as those under section 877 would apply, except a \$5 million floor would apply and U.S. real estate subject to the Foreign Investment in Real Property Tax Act of 1980 would be excluded. The proposal would create a special rule for those residing abroad to ensure that if they meet the residency test for at least three years, they would not be subject to a departure tax.

“Obviously, there are a lot of people who have been living overseas a long time,” Serrato said, and the increased \$5 million floor would help them avoid a penalty when moving to a residency-based system. “We don’t want those people to be negatively implicated. We want to try and make this as seamless as possible.”

Section 877, pertaining to the taxation of expatriates, provides for taxing individuals with an average annual net income tax greater than \$160,000, a net worth of \$2 million or more, or those who fail to certify under penalty of perjury that they have met the relevant requirements for the five preceding tax years. Section 877A imposes a mark-to-market regime on property of a covered expatriate, subject to an exclusion amount.

U.S. expatriations have been at or near a record pace for the past several quarters, with many blaming compliance burdens related to the enactment of the Foreign Account Tax Compliance Act for the uptick. Before related regulations were released in 2013, the number of U.S. expatriations rarely exceeded 500 in a

quarter. In recent years, numbers well over 1,000 per quarter have not been uncommon. (Prior coverage: *Tax Notes Int'l*, Nov. 14, 2016, p. 670.)

The American Citizens Abroad proposal also calls for repeal of the section 911 foreign earned income exclusion and housing cost amount. Under current law, the earned income exclusion is \$100,800. The estates of nonresident Americans would be taxed on only U.S. property, rather than on their worldwide assets, similar to the estates of nonresident aliens. The proposal also includes antiabuse provisions, including one that would tax gains on sales of securities within two years of the issuance of a departure certificate.

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