AMERICAN CITIZENS ABROAD
THE VOICE OF AMERICANS OVERSEAS

# Adapting the U.S. Tax Code to the 21st Century

# ELIMINATE DEFICIENCIES OF THE SOCIAL SECURITY SYSTEM

## Deficiencies with the current system

Americans with careers split between the United States and overseas face penalizing measures under the U.S. citizenship-based taxation. One area of penalization involves contributions to Social Security (SS) and Medicare as well as distributions of U.S. SS. Another relates to U.S. taxation of foreign government social welfare.

**Contribution issues** affect all Americans abroad as there is lack of choice. Those engaged by a foreign employer cannot contribute to U.S. SS whereas those employed abroad by U.S. companies and self-employed Americans overseas are required to contribute; the latter affects particularly Americans residing in countries that do not have a Totalization Agreement with the U.S. For instance, an American entrepreneur working in Brazil is subject to both local and U.S. SS contributions. This creates a severe competitive disadvantage, accentuated by the Affordable Care Act that adds a 0.9% Additional Medicare Tax on self-employment income and on wages subject to FICA, increasing double taxation of social contributions to 16.2%. To attenuate double taxation, the U.S. has signed Totalization Agreements with 25 countries which allow for contributions to SS programs to be made to only one country. They also provide for a transition period during which contributions to the country of origin can continue. For employees sent overseas on short-term missions, this allows individuals to remain in their home country SS systems. Totalization Agreements also allow many Americans and non-Americans to receive SS benefits if they meet the 10 year minimum contribution requirement by combining contributions to the U.S. and foreign system. Unfortunately, there are only 25 Totalization Agreements, while there are 196 countries in the world. There is a disincentive for Americans to create businesses in countries without Totalization Agreements.

**Distribution issues** are linked to the Windfall Elimination Provision (WEP), which affects Americans who have part of their careers overseas and consequently receive foreign pensions upon retirement.[1] WEP reduces by up to 50% U.S. SS payments to Americans who receive foreign social security and/or pension payments because their salaries earned overseas were not subject to U.S. SS.[2] WEP targeted double dipping by employees of U.S. States who received "full government pensions". Foreign social security annuities are not "full pensions" as they are proportional to the duration and amount of contributions. Furthermore, Americans abroad who have paid FICA taxes (for SS and Medicare) do not generally engender Medicare costs for the U.S. Federal government when they are covered and receive medical care overseas.

Distribution is also affected by filing status. Many Americans abroad file "Married Filing Separately" which taxes SS benefits heavily. IRS rules for taxation of SS retirement benefits indicate that there is a zero level of base income above which SS benefits will be taxed (85% of the benefit will be taxable) for those who file as married filing separately which disproportionately affects Americans overseas. At least one-third of Americans overseas are married to foreigners and file married filing separately.[3]

In addition, the U.S. taxes foreign government invalidity and welfare payments to handicapped, unemployed and disadvantaged Americans resident abroad who face an insurmountable and unfair burden of compliance.

## Recommended changes in the law

Contributions to U.S. SS should be voluntary for all Americans working abroad, irrespective of whether they are self-employed or earning wages as an employee of a U.S. or a foreign company.

Many more Totalization Agreements should be put in place.

Any American living overseas who is married to a non-American can choose the Head of Household status.

WEP legislation should apply only to individuals receiving domestic U.S. government pensions or WEP should kick in only if the combined U.S. and foreign SS pensions are higher than the maximum SS benefit if the individual had paid into U.S. SS for the combined years of US and foreign SS contributions.

Accept that foreign government invalidity, unemployment and social welfare payments to handicapped and disadvantaged Americans overseas be taxed only by the country of residence making the payments.

[1] http://www.ssa.gov/pubs/EN-05-10045.pdf provides the general rules of WEP and the formulas for reductions in Social Security payments under WEP. If you have 30 or more years of substantial earnings under Social Security, WEP does not apply. If a foreign government pays a pension after a specific age whether or not the individual has ever worked there, such as is the case in Israel, this pension would be subject to WEP.

[2] For details, see: http://www.socialsecurity.gov/retire2/wep-chart.htm#ely

[3] According to post election surveys of Overseas Vote Foundation, www.oveseasvotefoundation.org