

Written Testimony of American Citizens Abroad, Inc.
Before the US House of Representatives Ways and Means Committee
Hearing on
THE 2017 TAX LAW AND WHO IT LEFT BEHIND
April 10, 2019

This testimony is submitted in connection with the hearing held on March 27, 2019.

My name is Marylouise Serrato. I am the Executive Director of American Citizens Abroad, Inc. (“ACA”), a qualified section 501(c)(4) social welfare organization. Alongside of ACA is American Citizens Abroad Global Foundation (“ACAGF”), a section 501(c)(3) publicly-supported charity.

ACA is a non-partisan volunteer organization. It is widely recognized as a premier thought-leader on issues affecting US citizens living and working abroad. It has over 40 years of experience.

ACA’s mission is to educate, advocate and inform both the US Government and US citizens living and working abroad on legislative and regulatory issues of concern to the overseas American community. The US State Department estimates this community to be nearly 9 million strong.

ACA appreciates the opportunity to submit testimony to the committee to outline how US citizens living and working overseas were overlooked in the passage of the 2017 Tax Cuts and Jobs Act (“TCJA”) signed into law on December 22, 2017.

While this testimony is directed at the problems created by Congress overlooking important subjects affecting Americans abroad, we want to emphasize, at the outset, that the best solution is not going back and cutting into the changes made by TCJA but rather by adopting residency-based taxation for Americans abroad. This is the simplest and most straightforward step. It can be made revenue neutral and “tight against abuse”. It can be done without doing injury to taxpayers benefitting somehow from the current rules. It would also bring the US into line with all other countries with the exception of hard-pressed Eritrea. It is the obvious thing to do. It is the right thing to do. ACA urges Congress to enact residency-based taxation.

Congress should immediately hold hearings on the subject of taxation of Americans abroad. All the relevant information should be put on the table. Affected taxpayers can tell their stories. Joint Committee on Taxation can lay out all the relevant information, including history of the rules, details of how they operate, revenue impacts and important issues, such as, various ways to make changes revenue neutral safeguard against abuse. Then Congress, with this committee leading the way, can craft reasonable, straight-forward legislation. In truth, it is simply not that difficult and not that momentous an undertaking.

TCJA moves international taxation to residence-based/territorial, but not for US citizens living and working overseas.

The TCJA moves the US international tax regime to a residency-based or territorial tax regime. That is to say that income not derived or earned in the United States will no longer be subject to US taxation. This territorial approach to taxation applies to US international corporations; however, individual US citizens will continue to be taxed based on their US citizenship or on a citizenship-based taxation regime (“CBT”), continuing to pay taxes to the US on income earned outside of the United States.

US citizens overseas face serious compliance and double taxation issues related to CBT, some of these now exacerbated by TCJA. Under CBT Americans overseas must file two tax returns, one in the country in which they are resident and a second return for the IRS. Some mitigating tools exist to help avoid double taxation. However, given that foreign tax policies often do not align perfectly the US tax regime, certain foreign taxes are not creditable against US taxes. Examples include certain foreign social taxes, VAT taxes and wealth taxes. Many countries use alternate taxation models to raise revenue and do not rely as heavily on income as a source. Additionally, the Foreign Earned Income Exclusion (“FEIE”), which annually excludes the first \$105,900 (2019 exclusion threshold) of income from US taxation, does not cover unearned income; income such as, employer contributions to foreign retirement plans, government pensions, disability payments and social security/pension payments.

The requirement of using the US dollar as function currency for tax filings often results in phantom gains on the sale of property leaving some individuals with no ability to pay this gain. US citizens who are earning in a foreign currency and not sourcing income generated in the United States, may take out a mortgage in another currency, pay back the exact same amount, and then just because the exchange rate moves against them, have to pay taxes on this phantom gain.

Foreign Companies owned by US Citizens now treated like large International Multinationals.

TCJA moves the US from a worldwide tax system to a participation exemption system by giving US (that is, domestic) corporations a 100% dividend received deduction for dividends distributed by a controlled foreign corporation (CFC). To transition to that new system, the measure imposes a one-time deemed repatriation tax, payable over 8 years, on unremitted earnings and profits at a rate of 8 percent for illiquid assets and 15.5 percent for cash and cash equivalents. The dividends received deduction, which obviously is a major benefit, is available only to US corporations that are shareholders in the CFC. The deduction is not available to individuals, nor is it available to foreign corporations, which, for example, are owned by US individuals, including individuals living abroad. On the other hand, the repatriation tax applies to everyone, not merely US corporations. Accordingly, a US citizen residing abroad, who is a shareholder in a CFC, might be subject to the repatriation tax.

There can be no justification for requiring an American owning and operating a restaurant in Bergen, Norway or a Yoga studio in France, 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 she doesn't comply, not only will she owe the tax but also penalties and interest. In the true sense of the word, this result is absurd. Note, these individuals might not have in hand the actual monies needed to pay this tax. ACA has heard of cases where individuals do not have the funds to pay the tax or have been forced into closing their businesses because they cannot afford to comply.

Treasury has been intransigent in its belief that the filing requirements for small businesses such as the ones noted above, does not present a significant economic impact on these small businesses and, therefore, the Regulatory Flexibility Act (RFA), which assesses the economic impact on small entities, does not apply. ACA testified to the IRS on these issues, recommending that a *de minimis* rule be applied to remove small taxpayers from the filing and, requesting that an RFA assessment be undertaken to understand the economic impact on small taxpayers.

<https://www.americansabroad.org/media/files/files/c850be73/aca-comm-testimony-irs-965-regs-22-oct-2018.pdf>.

Americans overseas do not qualify for special reduced "passthrough" rates.

TCJA allows a deduction of up to 20% of passthrough income for specified service business owners with income under \$157,500 (twice that for married filing jointly). The passthrough tax break, however, will not help Americans abroad because it only applies with respect to domestic business income, that is, items of income, gain, etc. that are effectively connected with the conduct of the trade or business within the US.

\$10,000 itemized deduction disallowed for foreign property taxes.

Foreign real property taxes can no longer be deducted under TCJA. This change came up in the context of proposals to eliminate all State and local property taxes, except when paid or accrued in carrying on a trade or business or an activity relating to the production of income. An exception allows a taxpayer to claim an itemized deduction of up to \$10,000 (\$5,000 for married taxpayers filing a separate return) for the aggregate of State and local property taxes not paid or accrued in carrying on a trade or business or an activity relating to the production of income and State and local income, war profits, and excess profits taxes. However, expressly cut out from this exception are foreign property taxes.

US citizens continue paying tax to fund Medicare without access to Medicare benefits.

The 3.8% net investment income tax to fund Medicare and The Affordable Care Act, remains in place under TCJA and continues to apply in a way that, for Americans abroad, exposes them to double taxation because they are not allowed to credit foreign taxes against it. At the same time, Americans overseas who pay into Medicare cannot

access Medicare benefits while resident overseas unless they return to the United States for treatment.

The Foreign Account Tax Compliance Act (FATCA) unchanged by TCJA.

The Foreign Account Tax Compliance Act, known as FATCA, was passed in 2010 as part of the HIRE act. FATCA requires foreign financial institutions (FFIs) such as, local banks, stock brokers, hedge funds, insurance companies, trusts, etc. to report the accounts of all US citizens (living in the US and abroad), US "persons," green card holders and individuals holding certain US investments, to the IRS or to the government of the bank's country for further transmission to the US through Intergovernmental Agreements (IGAs) or be subject to a 30% withholding on their US investments.

The legislation was targeted at "bad actors" namely, Americans resident in the United States but holding undeclared offshore accounts for tax evasion purposes. For Americans living overseas the financial accounts held in the country of their residency for purposes of running a business or their everyday lives, are not offshore accounts being used to evade US taxation. As a result of the legislation, foreign banks and financial institutions, due to the increase compliancy cost and fear of penalty application, are simply closing the accounts of Americans living overseas or limiting/refusing them services.

A recommendation from the National Taxpayer Advocate and ACA to adopt "Same Country Exemption"¹ which would exclude from FATCA reporting for Americans overseas accounts held in the country of residence, was not considered for inclusion in TCJA, even though the problems of FATCA are well known to Congressional offices. Hearings on the problems related to FATCA were held on April 26, 2017 and legislation to provide safe harbor or Same Country Exemption for Americans overseas was introduced by Representative Maloney.²

Added to the problems of FATCA is the increased compliance, and confusion, resulting from identifying accounts that are reportable on a FATCA Form 8938 and those reportable on a similar bank account reporting form, the FBAR (Foreign Bank Account Report) or FinCEN form 114. A recent GAO report highlights the problems inherent in these overlapping filings and the increased compliance burden on Americans overseas. The GAO report also acknowledges the issue of bank account "lock-out" affecting US citizens overseas as a result of FATCA. https://www.gao.gov/products/GAO-19-180?utm_source=onepager&utm_medium=email&utm_campaign=email_%20si

¹ <https://www.americansabroad.org/media/files/files/feffd7bf/same-country-exemption-2015-04-06.pdf>

² The Overseas Americans Financial Access Act (H.R. 2136); <https://www.congress.gov/115/bills/hr2136/BILLS-115hr2136ih.pdf>.

Complex, costly and time-consuming tax filing unchanged for Americans overseas.

One of the promises of TCJA was the simplification of tax filing for all US citizens. For Americans overseas there was no improvement in, or simplification of, their tax filings requirements.

This is evidenced above with FATCA and FBAR reporting. Duplicate reporting requirements and complex and costly filing requirements remain the norm for most Americans overseas. For those Americans with overseas businesses the compliancy has increased given the already complex and time-consuming filing requirements and now the new requirements imposed by the transition tax. Forms such as the 5471 (Information Return of US persons with respect to certain foreign corporations) with 29 pages of instructions, averages 40 hours to complete with an average of 100 additional hours needed for learning the relevant law and record- keeping. Form 8421 (Information Return by a shareholder of a Passive Foreign Investment Company) –most foreign mutual funds and pension funds are classified as such - requires approximately 21 hours to complete with an additional 28 hours for learning the relevant law and record keeping.

Most Americans overseas, in order to correctly file their taxes, must hire a professional tax preparer. The cost of hiring a competent US tax preparer for international issues is multiples of the cost of a domestic preparer and, off the shelf software is not sufficient for most cases. Turbo Tax is woefully inadequate for all but the most basic tax reporting for overseas Americans. Even the most professional software programs get many things wrong for overseas Americans.

Congress must address the legislative and regulatory issues affecting Americans overseas.

In the development and passage of TCJA there was minimal focus on the concerns of the community of Americans living overseas. Little consideration was given to how the changes in tax law would affect overseas Americans, as is evidenced by this testimony. Particularly egregious is the treatment of Americans overseas under the new international corporate tax regime where a *de minimis* ruling was not applied in order to take out from reporting small tax payers and, Treasury's arbitrary determination that the Regulatory Flexibility Act ("RFA") does not apply because shareholders of foreign corporations are not *small entities*.

The logical way forward is for the United States tax code to come into the global norm and tax its citizens based on residency and not citizenship. Legislation introduced in the last Congress by Representative Holding, "The Tax Fairness for Americans Abroad Act of 2018" (HR 7358) would resolve many of the issues outlined in this testimony. It is our fervent hope that the 116th Congress will consider holding hearings on the legislative and regulatory tax issues affecting Americans living and working overseas. There is no reason US citizens who live overseas because they work in US multinationals and foreign companies, have started their own businesses, work for NGOs and non-profits,

serve as missionaries, were born overseas, hold dual citizenship, or simply have decided to build a life outside of the United States, should be left out in the cold when it comes to tax reform.

Again, we thank you for this opportunity to testify.