

Select Revenue Measures and Oversight Subcommittees
Joint Hearing on “Minding the Tax Gap: Improving Tax Administration for the 21st Century”
Thursday, June 10, 2021

STATEMENT OF AMERICAN CITIZENS ABROAD, INC. AND AMERICAN CITIZENS ABROAD GLOBAL
FOUNDATION

American Citizens Abroad, Inc. and its sister organization, American Citizens Abroad Global Foundation hereby submit our Statement for the record.

American Citizens Abroad, Inc. (ACA) is a qualified section 501(c)(4) non-profit membership organization, which advocates on behalf of Americans abroad. Its sister organization, American Citizens Abroad Global Foundation (ACAGF), is a qualified section 501(c)(3) tax-exempt public charity, which identifies subjects that affect Americans abroad, develops information about these subjects and provides such information to Congress, Treasury Department and other relevant persons. ACA and ACAGF (collectively, ACA) favor a balanced approach to subjects, supporting efforts that provide tangible results and practical solutions. Has been in existence since 1978. It is strictly nonpartisan and is the largest such organization representing Americans abroad. It maintains its headquarters in Washington, DC in order to be close to Government. It has chapters elsewhere, including London in Geneva.

ACA is very active in a number of theaters, especially with respect to taxation, voting and citizenship. It is the premier thought-leader on issues affecting US citizens living and working overseas.

<http://www.americansabroad.org>; <http://www.acaglobalfoundation.org>.

ACA represents Americans abroad. These are overwhelmingly individuals who truly reside in a foreign country. Many of them have resided there all or most of their lives. These individuals are essentially the same as their fellow Americans living state-side. Their income, their wealth, their approach to saving and retirement, everything else about their lives, looks very much like these things look for their fellow Americans living in one of the States or the District of Columbia.

The great majority of our members are long-term residents overseas. Some, a growing number, move around a great deal or at least do so for part of their life. Some of these can be characterized as “nomads” or “digital nomads” because, generally speaking, they appear to reside in no one particular place. Many of our members are retired. Some are what are referred to as “accidental Americans”. Many are small businessmen/businesswomen and many of these own their own small business, which business is commonly characterized as a corporation for US tax purposes. Of course, some of our members are relatively new to their foreign residence having only recently moved abroad. Some will move to the US for myriad of reasons, including old age or health.

Our members are involved in the full range of economic activity, from working for US and non-US companies, to owning and operating their own business, to providing a wide range of services. A member might be an older individual living with his family in Scotland, or a young chef running her own restaurant in Norway, or an investment advisor living in London, or an entrepreneur starting-up a green energy business in Egypt, or just about anybody else you can imagine, but always residing outside the US.

Closing the Tax Gap

ACA recognizes that the Administration and many Members of Congress, both Democrats and Republicans, are strongly interested in “closing the tax gap” and making the administration of our tax laws simpler and more efficient. An element in the tax gap is sometimes referred to as “foreign” or “offshore” noncompliance. Like other elements of the tax gap, this noncompliance should not be treated as synonymous with willful tax evasion. A great deal of it is due to ignorance of the rules and the rules’ mammoth complexity.

Some Members and officials in Treasury are also interested in tamping down the use of low- or zero-tax jurisdictions, discouraging zero-tax outcomes for US individuals and enhancing exchange of information, including exchange of information with so-called “tax havens”.

ACA shares the interest in closing the foreign tax gap and in combating criminal tax evasion. However, ACA’s members, we believe, are generally tax compliant and those that are not are not acting knowingly or willfully.

ACA, years ago, developed the ACA Expat Tax Services Directory, which is a popular source of information about preparing and filing US tax returns. It helps taxpayers find return preparers and similar service providers. <https://acareturnpreparerdirectory.com/>. It also represents and helps educate preparers and taxpayers. ACA meets with the IRS on a regular basis to discuss tax administration issues affecting individuals abroad and the education and regulation of return preparers.

ONE OF THE BEST WAYS TO COMBAT THE FOREIGN TAX GAP, SO FAR AS IT RELATES TO INDIVIDUALS, IS TO ENACT RESIDENCE-BASED TAXATION (RBT).

This is not the place to go into a great deal of detail, but ACA would like to bring a number of points to Members’ attention.

- 1. RBT is an important step in the right direction.*

While to some it might seem incongruous, taking law-abiding, compliant Americans, who are truly resident abroad, out of the system, or at least not taxing them on foreign income, can be a big step toward narrowing the “offshore” tax gap and making our system of tax administration simpler and more effective.

What are we talking about? Residence-Based Taxation means taxing people where they live, not according to their citizenship or nationality. The US, unlike all other countries except hard-put-upon Eritrea, taxes people on the basis of their citizenship. US citizens are taxable on their worldwide income regardless of where they live, where they work, where their income comes from, or anything else. This is a big problem for the millions of Americans living abroad, and administering these rules and chasing after individuals who for whatever reason are out of compliance, is an extremely difficult, time-consuming and expensive exercise for the IRS and the Justice Department. Any IRS examiner who has had to deal with Expat Americans owning and operating a small business outside the United States, dealing with individual tax issues, corporate tax issues, CFC issues, PFIC issues, and the like, will quickly agree.

Switching from current citizenship-based taxation (CBT) to RBT need not be difficult. In a word, Americans truly resident in a foreign country would be treated, by and large, like nonresident alien individuals (foreign individuals). They would not be taxed on their foreign income. They would remain taxable on their US source income. They would remain US citizens. They would still have to file abbreviated forms claiming RBT treatment and, in effect, certifying that they qualify. A good place to start with the details is [ACA's side-by-side analysis of current law and a "vanilla" approach to RBT](#).

Important above all else, RBT can be made revenue neutral – not lose money for the US Treasury, tight against abuse – not open to loopholes, and no one need be worse off than they are now.

ACA, working with District Economics Group, dug deeply into this subject in 2017. See [District Economics Group Summary of Analysis of a Basic Residence-Based Taxation \(RBT\) proposal](#). We are now updating, refining and expanding this analysis.

We have not kept this project under a bushel basket. Among other things, we have met, sometimes more than once, with all the tax-writing committee staffs and Treasury Department policy and tax analysis staffs. We have in our possession and have developed a great deal of baseline data. Our membership is a great source of information. Also, the population of return preparers using our Directory is another valuable source.

American Citizens Abroad Global Foundation at this moment is in the midst of its fundraising campaign to raise monies to support additional research work in support of Residence-Based Taxation. <http://www.acaglobalfoundation.org/donate>.

2. Instead of helping combat foreign noncompliance, would RBT open loopholes that you could drive a truck through?

No. The basic rules can be structured to be tight against abuse. The tax staffs on Capitol Hill are very good at drafting provisions "tight".

Among other things, in order to "get within" the RBT regime, one would have to be compliant and perhaps compliant looking back for some number of years. To qualify you, would have to be truly "resident" in a foreign country. You would have to prove that you are resident there and subject to that country's tax regime. Strict rules would apply to avoid people crossing their fingers gaming the system. Depending on how Treasury crafts the rules, it might be a requirement that you have to be resident in a non-"tax haven". To be a "non-tax haven" for these purposes, the country in question might have to exchange information with the US on individuals. If a country did not want to exchange information, that would be fine, but it would make itself unattractive to wealthy Americans.

Long-term residents overseas might be "grandfathered" into the RBT system. New-to-foreign residents ("newbies") might have to meet an aging test; that is, they might have to have resided there for some period of time.

In order to avoid hemorrhaging revenue, some form of "transition tax" may be considered. This is not an "exit tax", because no one is "exiting" from the US tax system. Rather they are transitioning from regular US taxpayers to US taxpayers taxed under the RBT regime. And there would have to be the usual rules to avoid people jumping in and out of the system, cashing out of assets when they are under RBT and then moving back to delightful Southern California.

Another requirement which should not be lightly overlooked is someone wanting to get within the RBT rules would have to reside outside the US. “Reside”, simply put, is almost certainly going to mean spending most of the year physically outside the US. It is a fact of life that not everyone, not every American family, is ready to live in another country, be overwhelmingly immersed in a different culture, deal with an entirely different set of day-to-day realities, and “sell this” to his or her partner, children and grandchildren.

3. Why all these rules? Why not let any US taxpayer residing in the US simply move to a foreign country, qualify for RPT, and no longer pay US tax or at least not pay tax on foreign income? Isn't that the fair thing to do?

This almost certainly will not “fly”. The loss of revenue would be humongous. There would also be – at least in the eyes of many – extremely unattractive results. Individuals who have made a fortune while living in the US would pick up sticks, move to a country where they would not be taxed or would be very lightly taxed, and “cash out”. They could then continue to live there or, later, move back to the US. It's impossible to envision a Member of Congress explaining to his constituents living next to him or her in Virginia, or Kentucky, or Tennessee, or wherever, why this was a good idea. Why should the neighbor continue to be taxed and the “fleet of foot” RBTer not be taxed? Fairness will only get you so far.

A good guess is there are about 5 million American taxpayers truly resident outside the US. Larger numbers, like 9 million, which pop-up on the internet include military, children, people are of very modest means, and others that can be set aside for this exercise.

Another guess is: 1 to 2 million Americans residing abroad, or claiming to reside abroad, are, to put it politely, “out of compliance”. Undoubtedly, some have a perfectly good explanation for this. Some do not. Some may be individuals who have renounced US citizenship and simply walked away not bothering to file the required forms and not paying taxes owed.

As for “guessing”, no one should have to guess about fundamental data like this. The IRS and Treasury Department must produce better information. They have known of the problem for some time now. There can be no excuse for not filling the voids.

We are pleased to hear that the IRS for at least the past 18 months, has been hard at work on updating and enhancing the underlying approach and methodology which can assist in identifying and forecasting compliance issues.¹

RBT would take the typical long-term foreign resident out of the system. They would no longer be taxed on their foreign income. Their filing requirements would be hugely reduced. They would also be taken out of the reporting rules applicable to Americans accounts and foreign financial institutions (FATCA). They almost certainly would still need to file Foreign Bank Account Reports (FBARS), but these filings, in a sense, help protect all of us given their use for combatting terrorist financing and drug running.

People who are innocently out of compliance should be given an easy way to catch up. This is especially the case with respect to “accidental Americans”. A form of relatively friendly “catching up” already

¹ Testimony of Douglas O'Donnell, Deputy Commissioner, Services and Enforcement, Internal Revenue Service, June 10, 2021.

exists with the voluntary disclosure program. This might be tweaked to make it still easier for these long-term foreign residents.

“Accidental Americans” should embrace RBT. There are many “accidental Americans” living outside the US. These are people who did not deliberately choose to be a US citizen. An example is someone born to non-US parents while her parents were studying, but apparently not just studying, in grad school in the US; the parents, with infant, moved back home to say Lausanne, Switzerland. This child grows into an adult, as children are wont to do, and is forever subject to US taxation, as if she lived in Mayfield, Kentucky. She did not realize she needed to report and pay US tax until her local bank started sending her reams of legal documents. There are tens of thousands of “accidental Americans”. Within this population there are many who truly did not have a clue that they were subject to US tax. Many did not even know they were an American citizen, not knowing that anyone born in the US is, loosely put, “automatically” a US citizen. There is also, we suspect, a small number that, frankly, kidded themselves to the point of losing touch with reality.

Alongside the subject of “accidental Americans” is the subject of advisors who have not done a good job helping the taxpayer remain compliant. And there are also advisors who are too quick to lead the individual down the path to renunciation of their US citizenship and then stand by while the individual fails to comply with all the rules, perhaps fails to pay the “exit tax”, and fails to appreciate the fact that while no longer a US citizen, he or she remains a US taxpayer. These advisors are a type of “ghost preparer”.

Residence-Based Taxation for individuals mirrors territorial taxation for US companies whereby US companies are not taxed on their foreign income. Switching from citizenship-based taxation, which taxes US individuals on their worldwide income regardless where they live, where they work, where they get their income, or anything else, need not be a big deal and serves the interest of just about everyone.