



AMERICAN CITIZENS ABROAD

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STATEMENT OF AMERICAN CITIZENS ABROAD
UNITED STATES SENATE COMMITTEE ON FINANCE
HEARING ON EARLY IMPRESSIONS OF THE NEW TAX LAW
APRIL 24, 2018
215 DIRKSEN SENATE OFFICE BUILDING

Organization Submitting this Statement

This statement is submitted on behalf of American Citizens Abroad, Inc., 11140 Rockville Pike, Suite 100-162, Rockville, MD 20852, USA. Additional information about ACA appears below.

Comments on TCJA

ACA is grateful to the Senate Finance Committee for holding this hearing on early impressions of the recently-enacted Tax Cuts and Jobs Act, which in many important ways rewrote the Internal Revenue Code. What was done and not done in this Act is especially impactful on Americans abroad.

What Was Done

Since Americans abroad are taxed the same as Americans residing in the US, just about all of the dozens of individual tax reform changes affect them. These include the changes in individuals' tax rates, deductions, credits, estate, gift and generation-skipping transfers taxes, changes in corporations' tax rates, small business rules, and many other provisions.

What Was Not Done

The big thing that did not change is the taxation of Americans residing – truly residing – in another country. They remain taxable based on their citizenship or citizenship-based taxation (CBT), meaning that regardless of the fact that they reside outside the United States, may have done so all their lives, may seldom if ever be present in the US, may have little or no US income, in other words have very little connection with the US, they are fully taxable under US tax principles. They have to file all the returns and related forms. They may actually owe US tax. We say “may” because, as is well-recognized, many of these individuals end up owing no US tax because of the workings of the foreign earned income exclusion and/or the foreign tax credit rules. Many file returns only because they have to in order to claim the exclusion and credits.

Americans abroad had hoped that provisions replacing citizenship-based taxation with residency-based taxation – RBT (sometimes called territoriality for individuals) would have been included in the Act. RBT simply treats Americans abroad, in general, like non-resident individuals and thus does not tax their foreign income. US income remains taxable. RBT is the simplest form of territoriality for individuals. It is the approach followed by all other countries with the exception of Eritrea.

Other Things That Were Not Done

A couple of other things were not done. First, the 3.8% net investment income tax to fund Medicare and The Affordable Care Act, was not changed continues to apply in a way that, for Americans abroad, exposes them to double taxation because they (and others) are not allowed to credit foreign taxes against it. Secondly, a same country exemption from the FATCA rules was not added to the statute. This exemption would give relief for the “lockout” problem causing Americans abroad to be denied financial services by foreign banks who are scared silly by the FATCA due diligence and reporting rules. (This exemption can easily be provided by the Treasury Department dropping it into the FATCA tax regulations, should it decide to do so.)



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The Most Serious Problem Areas

For Americans abroad, there are several serious problems with TCJA, and ACA respectfully requests that these be carefully analyzed and steps taken to correct them.

(a) *The new participation exemption system* adversely affects Americans abroad by not providing the dividends received deduction and yet taxing an individual on the deemed distribution. The Act 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). (New section 245A of the Internal Revenue Code.) To transition to that new system, the Act imposes a *one-time deemed repatriation tax*, payable, if elected, 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. (New sections 78, 904, 907 and 965 of the IRC.) 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 would apply to everyone, not merely US corporations. Accordingly, an individual, for example, a US citizen residing abroad, who is a shareholder in a CFC, while not able to benefit from the 100% dividends received deduction, might be subject to the repatriation tax. Note, this individual might not have in hand the actual monies needed to pay this tax.

This change is likely to come as a surprise to many Americans abroad who own foreign companies with accumulated earnings and profits. It is very common for American individuals living and working in a foreign country to own a foreign company. He or she might have a small business that is owned and operated through an entity created under local foreign law but characterized as a corporation for US tax purposes. This might be done to comply with local rules that influence the decision to incorporate. It might be done to protect against all kinds of different liabilities under local rules. Most Americans abroad who are “hit” by these new rules will not have “incorporated” with US taxes in mind. In fact, they will not have thought about all of the detailed rules and nuances governing characterization of entities for US tax purposes.

Lastly, on this point, in TCJA is a new “*downward attribution*” rule. (New section 958(b) of the IRC.) This is a hypertechnical change to hypertechnical existing provisions. But for some Americans abroad it is a disaster. Without wading into the mind-numbing details, an American residing, say, in Norway, owning and operating a restaurant, through a local company, together with a foreign family trust or estate, might suddenly find himself treated as a shareholder in a controlled foreign corporation and subject to the new rules. It will take months to figure out how these rules apply and to calculate the amount of tax owed. There is no de minimis rule to save small taxpayers from having to deal with this change. The cost of complying – making the calculations and preparing and submitting the returns – could easily exceed the actual tax liability.

(b) *Special reduced rates for so-called “passthroughs”* inexplicably, ACA thinks, do not benefit Americans abroad that earn foreign income through a passthrough entity.

The 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). (New section 199A of the IRC.) The rationale is because corporate rates were dropped from a graduated rate structure with the top rate of 35% to a flat 21% rate, unless something was done for unincorporated, so-called passthrough arrangements, such as partnerships and limited liability companies, as the owners of these are taxed at individual rates which rapidly proceed well above 21% to as high as 37%, these businesses would bear a significantly higher burden. Many unincorporated businesses would be driven to incorporate themselves – a step that, setting aside tax considerations, should be completely unnecessary. The passthrough tax break, however, will not be useful for Americans abroad because it only applies with respect to domestic



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business income, that is, items of income, gain, etc. that are effectively connected with the conduct of the trade or business within the US.

Ironically, this is a prime example of “upside down” territoriality so far as individuals are concerned. Under a territorial approach, such as, residency-based taxation, the taxpayer is expressly not taxed on foreign income. Here, the taxpayer – say, an American abroad – for sure will be fully taxed on foreign income, whereas his or her cousin in the States who earns domestic business income will enjoy the 20% deduction.

(c) Foreign real property taxes can no longer be deducted under the Act. This change came up in the context of proposals to eliminate all State, local, and foreign property taxes and State and local sales 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 real property taxes. Political considerations attaching to individuals’ real property taxes in high-tax States, such as, California and New York, did not come into play with individuals’ foreign property taxes. These rules apply to taxable years beginning with 2018 and ending with 2026. Many Americans abroad are hit by this change.

These new rules enacted as part of TCJA generally are effective in 2018.

Taken as a whole, these changes to the Internal Revenue Code, made by TCJA, appear to be a mishmash of actions taken without thinking about their effects on Americans abroad. In the minds of Americans living – truly residing, many of them for all of their lives – outside the US, they are like forgotten relative, poor uncle Jube, who is always overlooked when it came time to make out the guest list for Thanksgiving or a christening. They don’t think Congress acted deliberately out of meanness. It’s just that it really didn’t pause to think about it.

ACA respectfully asks that Congress now think about all of this carefully.

When the numbers are analyzed, a baseline constructed, which touches upon all the data, and revenue estimates are run, the taxation of Americans abroad is not a big thing so far as the federal fisc is concerned. The time has come, in fact long since passed, when we should switch from citizenship-based taxation to residency-based taxation. This would solve all the problems – hypertechnical and other – created by TCJA. It would solve the problems, including the “lockout problem”, created by FATCA. Importantly, and everyone should pay close attention here, this can be done without a loss of revenue. To be done so as to be revenue neutral, tight against abuse and in a fashion that leaves no one worse off than they were before the switch, smart decisions need to be made and close attention must be paid to the details.

In order to advance the ball, ACA and its sister organization, American Citizens Abroad Global Foundation, since late 2016 has developed a set of options, referred to as a “vanilla approach”, to changing from CBT to RBT. A side-by-side comparison of current law to “vanilla approach”, revised five times and now reflecting the recent TCJA changes, can be found at <https://www.americansabroad.org/files/649/>. ACA, together with District Economics Group, has also worked to develop a highest-quality baseline set of data. As a result, we believe that RBT can be made revenue neutral if careful choices are made as to its details. https://www.americansabroad.org/media/files/files/dc1e1c4e/DEG_short_memo_on_RBT_proposal_11.06.2017.pdf.



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ACA urges Congress to revisit these subjects and enact residency-based taxation.

Respectfully submitted,

AMERICAN CITIZENS ABROAD, INC.

For additional information about ACA, go to <https://www.americansabroad.org/> or contact Marylouise Serrato at info@americansabroad.org. 202 322 8441

Nothing in this statement is intended as legal or accounting advice. Individuals should consult their own tax advisors.

This statement was prepared by Charles M. Bruce, Legal Counsel, ACA and Chairman, American Citizens Abroad Global Foundation. Mr. Bruce is Of Counsel to Bonnard Lawson-Lausanne. He is solely responsible for any errors or misstatements.

ACA is a nonprofit, nonpartisan, volunteer, membership organization. It is qualified as a tax-exempt social welfare organization (section 501(c)(4)) of the Internal Revenue Code. Alongside it is American Citizens Abroad Global Foundation, organized as a publicly-supported charity under section 501(c)(3). ACA is the successor of American Citizens Abroad, which was organized as a voluntary association by American expatriates mainly in and around Geneva in 1978.

- Early on, ACA was instrumental in getting citizenship legislation rewritten in order that children of US citizens, who had not met certain then-existing US residency requirements, were eventually able to do so.
- ACA was instrumental in increasing the FATCA (Foreign Account Tax Compliance Act) Form 8938 filing thresholds for US citizens living and working overseas, from \$50,000 to \$200,000.
- ACA was instrumental in getting the IRS to introduce its Streamlined Foreign Offshore Program.
- ACA was instrumental in showcasing the importance of the Foreign Earned Income Exclusion (FEIE) resulting in the introduction of legislation in 2011 by Congresswoman Maloney and Congressman Garrett calling for the removal of the cap on the Foreign Earned Income Exclusion.
- ACA has developed approaches to enactment of residency-based taxation in lieu of citizenship-based taxation, beginning with a forum/debate on “Taxation of Americans Abroad in the 21st Century: Citizenship-Based Taxation vs. Residency-Based Taxation”, held at the University of Toronto in May 2014.
- ACA developed and launched in June 2014 the ACA Tax Return Preparers Directory, which provides an online comprehensive listing of specialist return preparers able to service Americans abroad. The Directory is free of charge for ACA members and the public alike. <http://www.acareturnpreparerdirectory.com/>
- At the time of enactment in December 2015 of section 32101 of the Fixing America’s Surface Transportation Act, empowering the State Department to revoke or deny passports in specific cases when taxes are unpaid, ACA succeeded in having inserted in the Joint Explanatory Statement of the Committee of the Conference, as part of the Conference Agreement, important ameliorative provisions.
- In March 2016, ACA, in cooperation with the State Department Federal Credit Union, ACA launched the ACA-introduced the SDFCU account for its members, extending banking services to Americans living overseas who previously were unable to open US bank accounts. The account can be opened and operated entirely online. It is available regardless of the fact that the account holder does not have a residence or even a mailing address US. The account is essentially the same as that enjoyed by consular officers and other Americans working at US embassies around the world. <https://www.americansabroad.org/sdfcu-account/>
- ACA was pleased to testify at the National Taxpayer Advocate Public Forum in May 2016, which placed on record the tax and compliance problems facing Americans living and working overseas.
- ACA has supported the repeal of the 3.8% surtax on net investment income, which results in double taxation for Americans overseas since foreign tax credits are not permitted to offset the tax.
- Posted on ACA’s website is a recently updated (April 12, 2018), highly useful presentation, with flowchart, on the determination and transmittal of US citizenship.