U.S. expats may be out of luck in tax reform

By Aaron Lorenzo

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U.S. citizens who live abroad are still pushing for their voices to be heard in tax reform, though their window of opportunity looks to be in the future.

Legislation moving quickly through Congress would end U.S. taxes on American companies' foreign profits, under a system known as territorial taxation, but it wouldn't alter the equation for their American employees stationed overseas, nor would it address other expatriates living outside the U.S. for other reasons.

Instead, they would continue to face citizen-based taxation rather than residence-based taxation, or RBT, a change they're fighting for in tax reform.

In citizen-based taxation, expatriates are subject to U.S. taxes on their foreign- and U.S.-source earnings; they get credits and allowance for taxes they pay abroad, though there can still be double taxation. Under RBT, their earnings from foreign sources would not be subject to U.S. taxes.

But the House passed legislation, H.R. 1 (115), without such a provision. The Senate bill scheduled for a floor vote next week also excludes RBT language.

"I'm disappointed this wasn't in the House or Senate packages," said Grover Norquist, president of Americans for Tax Reform.

At this point, the best chance to make the change is probably down the road, said one of the issue's chief champions on Capitol Hill, Rep.George Holding (R-N.C.). He plans to introduce a bill as a separate follow-up to the sweeping legislation that GOP lawmakers hope to get to President Donald Trump by the end of this year.

A provision in the broader tax legislation that would allow companies to benefit from a territorial tax system should also extend to U.S. expatriates "to ensure that American citizens have a level playing field around the globe as well," said Holding, who sits on the tax-writing Ways and Means Committee.

It's a matter of fairness, Norquist said, to give equal treatment to U.S. multinational companies and U.S. citizens abroad. If the fix for individuals doesn't ride with switching to territorial taxes for companies, it will be addressed soon, most likely in entitlement overhaul legislation he expects to come up in April.

"The current system disadvantages Americans working overseas just as it disadvantages American multinationals overseas," Norquist said.

An estimated 8 to 9 million Americans live and work abroad, and about two-thirds of them consider themselves long-term or permanent overseas residents. Most are well-educated, white collar workers, Holding said.

All of them benefit to some degree from credits and exclusions that account for taxes they pay where they live, but they nonetheless must deal with compliance that involves extensive paperwork to report to U.S. authorities. An exclusion for foreign earned income totaled $102,100 per person this year, and expatriates can claim a credit for foreign taxes that are imposed by a foreign country or U.S. possession.

According to Holding, the citizen-based taxation system they continue to face is outdated, complicated and costly. Expatriates pay $4,000 on average to file their taxes annually, a factor, along with burdensome bank reporting requirements in the Foreign Account Tax Compliance Act, in prompting some to renounce their U.S. citizenship, he said.

"That's a base erosion of human capital," Holding said.

In addition, switching to an RBT system would harmonize the U.S. with much of the rest of the world, and it wouldn't overly burden the IRS with new rules since it already applies RBT to nonresident aliens in the U.S.

But Holding hasn't decided on exact language for a bill, which according to some estimates could result in $20 billion in lost revenue over a decade, Norquist said.

Among options Holding is considering would be legislation to allow full RBT, or instead changes to the foreign earned income exclusion.

One group representing U.S. expatriates, American Citizens Abroad, is pushing a bill that wouldn't reduce federal revenue by changing to RBT. The current citizen-based taxation only raises about $5 billion to $8 billion annually.

The group's plan would include a number of requirements meant to guard against abuse, such as compelling U.S. citizens to prove they've established residence in a foreign country with an individual income tax greater than a token amount.

It would also require expatriates to prove that they resided in their adopted country for a five-year period prior to getting into the RBT system and that they filed all required U.S. income tax returns over that period. It also proposes a departure tax if the expatriate's assets exceed $3 million, part of preventing someone from opting into the RBT system for tax evasion purposes, and they'd have to pay a $2,350 fee to choose RBT.

But these anti-gaming provisions could be waived to grandfather in expats who can prove they've established overseas residences long ago.

At the very least, proving this bill language can be revenue neutral establishes a useful baseline for advancing the cause, said the executive director of American Citizens Abroad, Marylouise Serrato.

In the more immediate term, the group is pressing for a Senate floor amendment to get RBT included into the Senate bill next week, though Serrato declined to identify members who might introduce such amendments. Whether RBT gets added to the Senate tax bill or tacked onto entitlement legislation, Norquist said American expats deserve to be next in line.

"We're talking to interested parties on the Senate side and we're making our case," Serrato said.

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