Group Insists Residency-Based Taxation Can Be Revenue Neutral

by Andrew Velarde

American Citizens Abroad (ACA), which has championed a move to residency-based taxation (RBT) for U.S. citizens for years, insists that such a pivot can be made revenue neutral and is touting a new study to support its claim.

ACA issued a release on April 25 announcing the results of its 10-month study based on analysis by District Economics Group as well as a side-by-side analysis of current law and a potential RBT approach.

"Long-term American residents abroad could seamlessly move from citizenship-based taxation, the current set of rules, to RBT. No one would be forced to do this. No one would be made worse off, as the existing foreign earned income exclusion rules would remain for those wishing to use them," the release states.

For years, the ACA has pushed for the shift in how U.S. citizens living abroad are subject to taxation, removing foreign income from the pool that is subject to U.S. tax, and have asserted that finding a revenue-neutral path away from citizenship-based taxation is key. This is the second study ACA has conducted. It revises a model developed in 2017-2018 by expanding the number of countries, accounting for the Tax Cuts and Jobs Act and the pandemic, and incorporating changes to income estimates based on numbers from the IRS and Federal Reserve Board. ACA anticipates presenting the study's results to congressional staff and Treasury.

The ACA study estimates that more than 2 million of the nearly 4 million Americans living abroad could be eligible to move to RBT over the 10-year budget window.

"From our recent meetings on Capitol Hill and with the Administration, we believe they will be very interested in this new and expanded analysis. ACA also looks forward to working with other groups interested in our work on RBT," Marylouise Serrato, executive director of ACA, said in the release.

Although legislation has gotten little traction in Congress, the ACA has attempted to keep lawmakers aware of the issue. In January 2021 eight organizations, including ACA, formed a coalition advocating for a move toward RBT. And in March the ACA submitted a statement to the House Ways and Means Committee calling for hearings to consider RBT legislation.

In December 2018 former Rep. George Holding introduced the Tax Fairness for Americans Abroad Act of 2018, which was designed to end "the onerous burdens of citizenship-based taxation," according to the bill's description. The bill would have allowed qualified nonresident citizens to carve out foreign-source income from gross income and exempt that income from U.S. taxation. The bill did not advance far, and Holding has since retired from Congress. But other legislators like Rep. Carolyn B. Maloney, D-N.Y., who has sponsored measures (H.R. 5799) looking to address compliance burdens encountered by U.S. citizens overseas, have also been targeted by the group for support.

The release argues that RBT can be elective and the existing foreign-earned income exclusion for those not electing the new regime could continue. Electing RBT requires an annual election confirming continued eligibility as a resident living abroad, the release states.

According to the analysis, anyone who has resided abroad for at least three years before RBT enactment would not face a transition tax or departure fee. Some individuals who are not long-term foreign residents would face a one-time charge of $2,350 if they wish to move to RBT, which would offset the revenue reductions from moving to RBT over the next decade without relying on increased compliance or enforcement, the analysis concludes. The $2,350 fee is equal to the State Department renunciation fee. This transition tax would be distinct from the section 877 and 877A exit tax for expatriating individuals, according to the section-by-section comparison. The threshold for individuals subject to the transition tax would be similar to the threshold for the exit tax ($124,000 average annual income adjusted for inflation or $2 million net worth), but net worth would be increased to $3 million and U.S. real estate subject to the Foreign Investment in Real Property Tax Act would be excluded, the comparison states.

Individuals who move abroad after enactment could qualify for RBT if they are bona fide residents of another country for five years, the release states.

Charles M. Bruce, counsel for ACA, told *Tax Notes* that the ACA now hopes for hearings on the taxation of foreign income of individuals, which has been largely ignored.

"This subject has not been laid bare . . . since the hearings on foreign-earned income exclusion in the '70s," Bruce said. "We hope this study — especially the finding that RBT can be made revenue neutral and new, realistic numbers about the population of Americans abroad — will help all of us." ■