



# Tax and the American abroad

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DEMOCRATS ABROAD TAXATION TASK FORCE

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# Introduction

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U.S. State Department estimates suggest approximately 9 million U.S. citizens reside outside the country. Globalisation is causing that number to grow despite the inherent – though inadvertent – ways the U.S. tax code and tax reporting requirements discriminate against those who move abroad.

The U.S. has a citizenship-based taxation system which obligates non-resident citizens to file tax returns on income generated in the U.S. and abroad, and also to report the financial accounts they have in foreign financial institutions. Complicated, expensive and stressful.

Further, some U.S. states behave aggressively in identifying those resident for state tax purposes. This gives Americans abroad reason to worry that voter registration, voting and voting for state offices in particular may give rise to a state tax liability.

These issues and concerns are discussed herein.



# State income tax concerns and overseas voter registration

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Americans living outside the USA vote from abroad by absentee ballots distributed by the states

Americans living abroad **must submit a voter registration/absentee ballot request for every year** that they want to vote

Voters provide **Voter identification**, normally a driver's license from the voting state or social security number (SSN) and the voter's **voting address** - a street address in the U.S.

Some states are *highly aggressive* in their pursuit of state income tax revenues and use evidence of state residency to assess liability. Anecdotal evidence demonstrates this is a serious consequential concern. **Overseas Americans from these states have noted their reluctance to register to vote in case it forms evidence of state residency for state income tax purposes.**



# Voter registration is not the sole basis for determining tax residency

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Many Americans abroad manage this risk by voting only for federal offices; many stop voting entirely and give up their franchise.

**Voting in an election for federal offices may not be used as the sole basis of determining residency for the purpose of imposing state (and local) taxes.**

Other factors taken into consideration *may* include\*: maintaining a permanent home in state; “substantial presence” in the state; family, business, social or other connections to the state; and other.

Some voters with this concern who receive the full state ballot from their Local Election Official vote only for the Federal offices on the state ballot, ie President, US Senate and US House of Representatives. The Local Election Official knows they’ve sent you a full ballot; but as ballots are secret, **no one knows which offices on the ballot you have voted.**

Neglecting to vote down ballot offices provides no further protection from state tax liability and only disenfranchises the voter.



*\* These provisions would be established state to state and perhaps not even published.*

# Taxation concerns of Americans abroad

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1. **Citizenship based taxation** – the law of the land since 1913. All Americans abroad groups are urging Congress to change it.
2. **Residency Based Taxation** – a reform whose time has come given 115<sup>th</sup> Congress intends to enact comprehensive tax reform.
3. **FBAR reporting** – disclosure of financial accounts in offshore banks if the taxpayer's aggregate balance exceeds \$10,000 at any point during the year. **A new deadline of April 15 is introduced this year.**
4. **FATCA reporting – the disclosure of accounts by some US taxpayers and foreign financial institutions.** The IRS can, in theory, use the disclosures by foreign banks to search for US tax payers not compliant with US reporting obligations. We believe they do not.
5. **Addressing areas of the tax code and aspects of filing that inadvertently discriminate against Americans abroad.**



# 1.1 Currently Citizenship Based Taxation is the law

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Americans are required to report their world-wide income to the IRS.

The Foreign Earned Income Exclusion combined with the deduction of taxes paid to the tax authority of the taxpayer's country of residence ensures many will owe no tax. But they still must file.

Many Americans abroad are not compliant with the US tax filing obligations due to ignorance, misinformation or confusion caused by IRS neglect.

Filing is complicated, time-consuming, expensive and stressful for even ordinary earners; specialist tax return preparers are very often required.

Whilst Citizenship Based Taxation is the law of the land Democrats Abroad recommends that Americans abroad who are not compliant with their tax filing obligations consider becoming so.

ACA has a global tax return preparer's directory where non-filers can find affordable support and advice about IRS tax amnesty.



# 1.2 Citizenship Based Taxation should be overturned

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Americans abroad suffer from grave misperceptions. We are not high rollers; we are ordinary, hard working Americans living abroad for family, school or employment. We're not gaming the international tax system. Taxes are higher in the places most of us live than in the US.

Many income types are left out of exclusions and are double-taxed or treated punitively.

The complexity and cost of filing and reporting from abroad makes it more difficult for Americans to find work, enter business partnerships.

FBAR and FATCA reporting, established to deter financial crimes but de facto tax enforcement tools, have compounded our problems.

Due to globalisation the number of Americans abroad is increasing so the problem is growing as well.





# 2.1 Residency Based Taxation

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Most countries do not tax the offshore income of citizens who are resident abroad. This is Residency Based Taxation and we support it.

DA and other organisations representing Americans abroad are pushing hard at this time to see Residency Based Taxation (or RBT) included by the 115<sup>th</sup> Congress in its personal tax reform package.

American Citizens Abroad is raising money to engage a “scoring agency” to develop an RBT proposal from their baseline proposal that is non-punitive to Americans abroad and revenue-neutral to the government.

(The Republicans have a proposal that is departure fee-free but appears to further complicate filing and will likely not be revenue-neutral.)

Democrats Abroad have no fixed view on what Residency Based Taxation should look like.



# 2.2 Residency Based Taxation

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Some key criteria for Residency Based Taxation or RBT might be:

- Includes straightforward criteria for Americans abroad to use in establishing eligibility;
- Does not impose punitive costs on or impact the freedom of movement of non-resident Americans who elect to stop filing;
- Is revenue-neutral to the federal government (in order to attract Congressional endorsement and expedite passage);
- Does not open loopholes or otherwise include avenues for high net worth migrants who would abuse it for the purpose of tax avoidance.

## 2.3 Residency Based Taxation

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Democrats Abroad has launched a multi-faceted campaign in support of Residency Based Taxation or RBT.

Congressional Call Storm – Thursday June 15<sup>th</sup> ; scripts provided.

### **Residency Based Taxation Campaign in a Box –**

- Find your elected representatives.
- Call them during the Call Storm (or at any time).
- Letter and Post Card Writing are helpful.
- If nothing else, participate in our email campaign – Democracy.io
- Please vote. In every election you can, in every year that you can.

# 3. FBAR Reporting

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Americans with \$10,000 or more in aggregate in accounts in foreign financial institutions are required to report the accounts to a division of Treasury known as the Financial Crimes Enforcement Network. FinCEN requires the reports to be submitted electronically.

**This year the report is due on April 15, 2017\***, unlike in the past when it was due to be submitted on 30 June.

Penalties for failure to report accounts can be highly punitive, even if the failure was due to ignorance, misinformation or confusion. The FBAR Form 114 includes a space for new FBAR filers to state the reason for past failures to comply.

DA recommends that Americans abroad use the ACA tax return preparers directory to obtain advice about filing new or delinquent FBARs or about the IRS's amnesty program for non-filers.

\* Filers have an automatic extension to October 15<sup>th</sup> with no need to apply for it.



# 4.1 FATCA Reporting

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The Foreign Account Tax Compliance Act (FATCA) requires taxpayers with accounts with aggregate balances over a specified threshold to report those accounts on IRS Form 8938. Further, it requires the Foreign Financial Institutions we bank with to also report on the accounts of US Persons.

Whilst many taxpayers abroad will be exempted from FATCA reporting because of the reporting threshold, the financial institutions we bank with will report ALL accounts held by US Persons.

**Americans abroad who don't file annual IRS returns may no longer feel safe hiding from the IRS "in the shadows" because their bank's FATCA filings may, in theory, be used by the IRS to identify them as out of compliance with their tax filing obligations.**

In reality, it is difficult to imagine the under-resourced IRS using FATCA filings for tax enforcement of ordinary non-resident Americans<sup>c</sup>



## 4.2 Fixing FATCA

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FATCA was never meant to target ordinary, hard-working Americans who use their a financial accounts to pay bills and save for the future. It was meant to apprehend and discourage high net worth Americans in the US using offshore accounts to hide untaxed earnings from the IRS.

**DA supports an exemption for Americans abroad from FATCA reporting by both the non-resident taxpayer and the financial institutions they hold accounts with: the Same Country Safe Harbor Exemption.**

In August Congresswoman Carolyn Maloney (D-NY12) introduced legislation implementing the Same Country Safe Harbor, which has the intention of ending the foreign bank lock out of Americans abroad and restoring to them a diversified supply of financial products and services

DA supports **H.R. 2136 the Overseas Americans Financial Access Act.** Even with RBT there will be foreign financial account disclosure.



# 5.0 Eliminating discrimination in taxation

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Areas of the US Internal Revenue Code were developed without due consideration for the impact they would have on overseas filers.

Many areas of the tax code, therefore, inadvertently discriminate against Americans abroad.

The following slides identify reforms needed to cure the inequitable tax treatment of overseas citizens and improve the process of tax filing and reporting for Americans abroad.

Even if Residency Based Taxation were implemented for qualifying US non-resident taxpayers, there will be those who elect to continue to file. The problems noted on the slides that follow will linger on for those filers if they are not addressed.

# 5.1 Eliminating discrimination in taxation

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**US Capital Gains Tax Exclusion** – harmonisation of capital gains treatment for properties owned by citizens living abroad with treatment of properties owned by citizens living in the US.

**Artificial Capital Gains/Losses due to Currency Fluctuations** – elimination of artificial capital gains and losses when no currency has been exchanged, by allowing the currency of the country of residence to be the functional currency for tax reporting purposes.

**Applying foreign credits to NIIT** – allow Americans abroad to apply foreign income tax credits in calculating Net Investment Income Tax

**Marital deduction for bequests to foreign surviving spouses** – reinstate the marital deduction for bequests to surviving foreign spouses in the calculation of estate tax.



# 5.2 Eliminating discrimination in taxation

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**Declaration of foreign long term savings plan income** – tax the income from foreign long-term savings plans at the time the money is withdrawn from the plan.

**Taxation of welfare payments** – tax foreign government invalidity, unemployment and social welfare payments to disabled and disadvantaged Americans abroad only by the country making the payments, ie the country of residence.

**Tax-free transfer of foreign retirement plan assets** – render tax-free the transfer of assets from foreign retirement plans deemed qualified plans under international tax treaties to retirement plans in the taxpayer's new country of residence, be it the US or another foreign country.

# 5.3 Eliminating discrimination in taxation

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**Revise punitive PFIC rules** – For citizens residing abroad revise the punitive Passive Foreign Investment Company rules and reporting requirements that apply to non-US pension plans, foreign mutual funds and other investment savings vehicles that prohibit Americans abroad from saving effectively for retirement.

**Taxation of non-US non-qualified pension plans** – simplify the reporting structure for non-US, non-qualified pension plans that would alleviate the onerous need for Form 3520 filings for non-employer funded pension schemes.

**Reforms to the FEIE and FHE** – maintain the Foreign Earned Income Exclusion, merge it with the Foreign Housing Exclusion and eliminate the ceiling. This would completely eliminate double taxation of earnings of non-resident taxpayers.

# 5.4 Improving tax filing for Americans abroad

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**Optional simplified earnings declaration** – for taxpayers abroad who owe no US federal or state income tax, provide non-resident taxpayers with the option of a one-sentence, handwritten or printed declaration of earnings, accompanied by a tax return or assessment from the taxpayer's country of residence.

**Translated IRS publications and forms** – provide translated versions of IRS publications and tax forms commonly used by non-resident, non-English speaking US citizens.

**Harmonise International Tax Treaties** – align all international tax treaties with the US Model Income Tax Convention of November 15, 2006 as they apply to private pensions, social security benefits, annuities, alimony, child support and pension plans.

# 5.4 Improving tax filing for Americans abroad

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**Promote the Streamline Filing Compliance (Offshore) Procedures** – expand awareness of the SFCP, a tax amnesty program introduced in 2014 for Americans who non-wilfully are not compliant with their tax filing and reporting obligations.

**Improve communication** – encourage the IRS to do even more to expand communication with Americans living abroad, starting with the reopening of its overseas offices and the restoration of offshore services lost due to cuts in IRS funding.

**Protect American Citizens Services** – ensure that Trump government proposed cuts to State Department funding do not result in further reductions in American Citizen Services provided out of US consulates and embassies.

# In summary

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Voting **will not be the sole factor** states take into consideration in assessing whether a non-resident taxpayer has state residency for tax purposes. If you can vote in down ballot races, please do.

Currently Citizenship Based Taxation is the law of the land. Americans abroad who don't file with the IRS considering becoming tax compliant can find affordable tax advice on the ACA Tax Return Preparer Directory.

The 115<sup>th</sup> Congress has made comprehensive tax reform a legislative priority. We are campaigning to make RBT a part of that.

Democrats Abroad is campaigning actively in support of RBT and HR2136, the Overseas Americans Financial Access Act. **Please support these campaigns.**

ACA is raising funds to establish and "score" (price) an RBT model that they will then lobby for. We support their work.



# In summary, cont

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This year (and going forward) FBARs are due 15 April/15 October instead of 30 June.

FATCA disclosures by banks can, in theory, be used by the IRS to identify non-compliant tax payers living abroad. Tax compliance is encouraged.

We are pushing the IRS to maintain and expand services to non-resident taxpayers and asking the State Department to protect funding for Consular services for American citizens abroad.

Many areas of the tax code inadvertently discriminate against Americans abroad. We are advocating for reforms to fix them. This will certainly take many years. RBT can be done more urgently.

**Please contact Carmelan Polce, Chair, Democrats Abroad Taxation Task Force, at any time with questions. [carmelanpolce@gmail.com](mailto:carmelanpolce@gmail.com)**





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