



How to Fix  
**23 Tax  
Problems  
for Americans  
Abroad**  
with Three Solutions

## **We are asking Congress to -**

1. Enact a switch from Citizenship Based Taxation to **Residency Based Taxation**.
2. Pass the HR 2136, the “**Overseas Financial Access Act**” – to eliminate the foreign financial accounts of Americans living abroad from reporting under Foreign Account Tax Compliance Act (FATCA).
3. Pass the HR 1205, the “**Social Security Fairness Act**” - to repeal the Windfall Elimination Provision that prevents Americans abroad with pensions in their countries of residence from claiming the full amount of Social Security payments owed to them.
4. Enact a **remedy for American business owners abroad** existentially harmed by the “transition taxes” built into the 2017 Tax Act.
5. Provide an **efficient mechanism for “Accidental Americans” to renounce** their unwanted U.S. citizenship.

## **We recommend Congress -**

- **Hold hearings** to investigate the myriad ways the U.S. Tax Code discriminates against Americans abroad and build support for these three critical reforms.
- Pass the HR 2710 - to establish a **Commission** to study the impact of Federal laws and regulations **on Americans living abroad** and to avoid passing laws that inadvertently harm Americans abroad in the future.
- Enact **reforms to the Foreign Bank and Financial Accounts Report (FBAR)** reporting requirement for US Citizens in their bona fide country of residence, especially to redress the enormous and out-of-proportion penalties for non-wilful non-compliance.

## **We urge Congress to -**

- ✓ Join the **Americans Abroad Caucus**.
- ✓ **Contact us** when you travel to our countries of residence. We would love to meet you in the places we live!

## INTRODUCTION

Democrats Abroad has documented herein the scope of tax problems that uniquely impact Americans living abroad. We hope that by profiling the wide range of U.S. tax code and other provisions that have – however unintended – severe adverse consequences for Americans abroad that we might persuade Congress to act on our behalf and resolve them.

The list includes 23 discrete matters and, to our disappointment, it has recently grown due to provisions in the 2017 Tax Cuts and Jobs Act. As is the case with most of the provisions that vex Americans abroad, the Repatriation Tax and GILTI provisions in the new law were enacted without due consideration for the impact they would have on non-resident filers.

Other examples include: the financial account reporting provision in the Bank Secrecy Act, which includes exorbitant and out-of proportion penalties for non-compliance and requires updates generally; SEC regulations and the USA PATRIOT Act which make both investing in the U.S. and investing abroad *extremely difficult* for Americans living abroad without a U.S. address; and the Windfall Eliminations Provision, which unintentionally denies fully entitled Social Security benefits to Americans abroad who have pensions in their country of residence. Saving and investing for the future is *extremely difficult* for Americans abroad because of these provisions.

Thus, we are burdened with an unfair, unreasonable and unjust compliance burden that causes financial and personal hardship and that will require remedies across myriad areas of the tax code and other laws, plus within existing U.S. double taxation treaties and the model U.S. tax treaty. We do not believe Congress has the time or political will to implement these remedies and so instead recommend three solutions that would eliminate the problems enumerated herein:

**1. A switch from our current system of Citizenship-Based Taxation to Residency-Based Taxation.**

There is evidence to suggest that Residency-Based Taxation can be implemented on a revenue-neutral basis<sup>1</sup>. A switch from Citizenship-Based Taxation to Residency-Based Taxation would resolve most of the tax problems outlined herein.

**2. A same country exemption for Americans abroad to eliminate FATCA reporting on financial accounts in their country of residence.** H.R. 2136, the *Overseas Americans Financial Access Act* would provide Americans abroad from relief from the unintended adverse consequences of the Foreign Account Tax Compliance Act (FATCA). FATCA was enacted to discourage and apprehend those using foreign bank accounts to commit financial crimes and not to cause personal and financial pain to ordinary Americans abroad who use accounts in their countries of residence to pay bills and save for the future.<sup>2</sup>

**3. Replace the Windfall Eliminations Provision with the Social Security Fairness Act (H.R. 2710).** To restore to Americans abroad the Social Security benefits they have earned and are entitled to.

Filing from abroad alone is inordinately complex and costly. The forms required to declare income generated abroad are highly detailed, preparing them is extremely difficult and it very often requires the support of professional tax return preparers with specialist knowledge of overseas filing.<sup>3</sup> Our recommendations address the filing costs for Americans abroad which far exceeds the costs incurred by U.S. based tax filers.

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<sup>1</sup> <https://www.americansabroad.org/files/586/>

<sup>2</sup> <https://www.finance.senate.gov/download/att-2-democrats-abroad-2014-fatca-research-report>

<sup>3</sup> [https://www.democratsabroad.org/can\\_we\\_please\\_stop\\_paying\\_twice\\_tax\\_reform\\_for\\_americans\\_abroad](https://www.democratsabroad.org/can_we_please_stop_paying_twice_tax_reform_for_americans_abroad)

## TAX CODE PROVISIONS THAT DISCRIMINATE AGAINST AMERICANS ABROAD - AND PROPOSED REMEDIES

In our examination of the provisions in the Internal Revenue Code that govern tax filing and reporting for non-resident Americans we have identified these areas that require remedies in order to address their perhaps unintended but certainly adverse consequences.

**Note:** A switch from [Citizenship-Based Taxation](#) to [Residency-Based Taxation](#) would resolve most of these issues for Americans living abroad.

1. **US Capital Gains Tax Exclusion** – harmonization of capital gains treatment for properties owned by citizens living abroad with the treatment of properties owned by citizens living in the US.
2. **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.
3. **Applying foreign credits to NIIT** – allow Americans abroad to apply foreign income tax credits in calculating Net Investment Income Tax.
4. **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. **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.
6. **Taxation of welfare payments** – tax imposed on foreign government invalidity, unemployment and social welfare payments to disabled and disadvantaged Americans abroad only by the country making the payments, i.e. the country of residence.
7. **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 country.
8. **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 using them to save efficiently for retirement.
9. **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.
10. **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 the earned income of non-resident taxpayers.
11. **Repeal WEP** – Replace the Windfall Elimination Provision (WEP) which drastically reduces the Social Security payments owed to Americans also receiving foreign pension payments with the Social Security Fairness Act to restore rightful Social Security payments to Americans abroad.
12. **15.5% Repatriation Tax** – Provide an exemption for small to medium sized business owners from the 15.5% Repatriation Tax. Meant as a tax break for American companies retaining profits abroad, it forces small to medium size business owners to declare profits set aside for future capital investment.
13. **GILTI tax regime** - Harmonise the tax treatment of Global Intangible Low Tax Income and Foreign Intangible Direct Income across all types of foreign corporations owned by U.S. persons or entities by giving pass through-type S corporations owned by Americans living abroad access to the same offsets and deductions afforded to C corporations controlled by U.S multinationals.

## IMPROVING TAX FILING AND REPORTING FOR AMERICANS ABROAD

Although these reforms would lose their importance for most Americans abroad **after a switch from Citizenship-Based Taxation to Residency-Based Taxation**, they would be enormously helpful for those who do not elect to file as non-resident US citizens for tax purposes.

14. **Optional simplified earnings declaration** – provide non-resident taxpayers who owe no US federal income tax 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
15. **Expand the criteria for determining the threshold for who has to file** – add a provision so that foreign earned income that can be excluded under current rules does not need to be included when determining your gross income for filing purposes.
16. **Make electronic tax return filing possible for non-resident taxpayers declaring foreign tax credits** - Allow taxpayers using the free, fillable IRS electronic forms to exclude the attachments eliminating the need for the taxpayer to file the return by post.
17. **Translated IRS publications and forms** – provide translated versions of IRS publications and tax forms commonly used by non-resident, non-English speaking US citizens.
18. **Harmonize International Tax Treaties** – align all international tax treaties with the US Model Income Tax Convention of November 15, 2006, especially (but not exclusively) as they apply to private pensions, social welfare benefits, annuities, alimony, child support and pension plans.
19. **Promote the Streamline Filing Compliance (Offshore) Procedures (SFCP)** – expand awareness of the SFCP, a tax compliance restoration program introduced in 2014 for Americans who non-wilfully are not compliant with their tax filing and reporting obligations.
20. **Improve communication** – encourage the IRS to do even more to expand communication with Americans living abroad, starting with the establishment of non-resident taxpayer support hotlines operated by officials schooled in matters unique to non-resident filers and including the reopening of overseas IRS offices and the restoration of offshore services lost due to cuts in IRS funding.
21. **Protect American Citizens Services** – ensure that proposed cuts to State Department funding do not result in further reductions in American Citizen Services provided by U.S. consulates and embassies, which often include advice about tax filing deadlines and local tax return services.
22. **Reform the Foreign Account Tax Compliance Act (FATCA)** – enact HR 2136 to exempt from FATCA reporting, by both the U.S. citizen abroad and their financial account provider, the financial accounts of law-abiding overseas resident U.S. citizens in their bona fide country of residence.
23. **Reform the Foreign Bank and Financial Accounts Report (FBAR) reporting requirement for U.S. Citizens in their bona fide country of residence** – as follows
  - Redress the enormous, out of proportion penalties – civil and criminal – imposed by the IRS for non-wilfully neglecting to file forms;
  - Adjust for inflation the \$10,000 aggregate threshold amount that triggers a FBAR filing requirement, which has not been adjusted since the Bank Secrecy Act was enacted in 1970;
  - Eliminate the duplication of information disclosed on the FBAR and FATCA reports;
  - Exempt U.S. citizens from reporting foreign financial accounts that are not reportable by financial institutions in their country of residence;
  - Address the vulnerability of FBAR data security inherent in electronic filing; and
  - Remove the burden imposed on filers who are computer illiterate or with no access to computers by eliminating recently introduced mandatory electronic FBAR reporting.

## REGULATIONS CONSTRAINING BANKING, INVESTMENT AND RETIREMENT SAVINGS FOR AMERICANS ABROAD

**Note:** A switch from Citizenship-Based Taxation to Residency-Based Taxation would resolve most of these issues for Americans living abroad.

Investment options for Americans abroad are increasingly limited and fraught. Due to SEC regulations and legislation designed to protect consumers in the market for financial products, a provider of financial fund products must be registered to sell and market their products in a foreign jurisdiction. Although U.S. brokerage firms have over time turned a blind eye to this requirement, more recently, in an atmosphere of increased disclosure and oversight, many have elected to prohibit clients residing abroad from buying U.S. mutual funds in order to avoid the registration requirement. Exchange-Traded Funds are a legal work-around for Americans abroad interested in a mutual fund-type investment exposure, however even Exchange-Traded Funds may not be an option for individuals whose foreign and/or U.S. bank and brokerage accounts have been closed.

Features of the U.S. tax code impacting investments, savings plans and retirement savings uniquely penalize Americans residing abroad in the following ways:

- Punitive taxation of retirement savings plans which qualify and are taxed under local laws but are not qualified plans for U.S. tax purposes;
- Punitive taxation of foreign government sponsored retirement savings plans that are not qualified plans for U.S. tax purposes;
- Capital gains tax laws that do not take into account currency fluctuations, thereby creating assessable capital gains upon the sale of assets even if no currency was exchanged;
- The inability to claim the foreign tax credit against taxes owing under the Affordable Care Act, the 3.8% Net Investment Income Tax;
- Inflexible regulations involving Social Security and Medicare contributions particularly disadvantage (double-tax and other) self-employed Americans abroad.
- The Windfall Elimination Provision which drastically reduces the Social Security payments owed to Americans also receiving foreign pension payments;
- The Social Security benefit taxation regime for taxpayers who are Married Filing Separately provides no exclusion for spouses. Americans married to foreign nationals normally file as Married Filing Separately and as such cannot receive the exclusion afforded Americans married to Americans who file jointly;
- Social Security contributions required of self-employed Americans abroad are taxed (15.5%) even if they are already making contributions to an aged pension contribution scheme in their country of residence;
- Welfare payments made by foreign governments to Americans who are disabled, unemployed or disadvantaged are subject to US tax though they are normally not taxed abroad.

### U.S. BANKING ALSO CONSTRAINED

The USA PATRIOT Act, ratified after the terrorist attacks of 9/11, established new “Know Your Customer” rules for US financial institutions. As a result, banks and financial institutions are no longer willing to hold or open accounts for customers whose only address is outside of the United States. This has constrained the banking, saving and investment activities of Americans abroad. A sensible reform would be to exempt American citizens living abroad from this provision even if they have only a non-US address.