



DEMOCRATS ABROAD

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STATEMENT FOR THE RECORD

Funding our Nation's Priorities: Reforming the Tax Code's Advantageous Treatment of the Wealthy

Democrats Abroad thanks the Special Revenue Measures Subcommittee for conducting the May 12 hearing on the above captioned and is pleased to provide this statement for the hearing record. Reforms to tax policy that target the wealthy draw particular attention from U.S. citizens abroad because we are often presumed to be members of this class. U.S. tax policy aimed at addressing offshore tax evasion by high earners and high net-worth Americans often has unintended adverse consequences for Americans who live abroad, the vast majority of whom are ordinary, law-abiding middle-class citizens living in countries with a higher overall tax burden than the United States.¹ We submitted a statement for the record to the Senate Finance Subcommittee on Taxation and IRS Oversight hearing on "*Closing the Tax Gap*" which addresses this matter directly; it is attached as an addendum for your review.

This submission focuses on the goal outlined by Chairman Thompson of creating a tax system that advances efforts to "foster a fairer and inclusive economic recovery" and which "levels the playing field for all taxpayers". Democrats Abroad is disappointed that tax issues impacting Americans abroad are consistently left out of these hearings. Here we provide an analysis of the ways the U.S. tax code inadvertently discriminates against Americans abroad and a proposal for reform that addresses the policy imbalances that arise due to persistent misperceptions that Americans living abroad are wealthy "fat cats" avoiding U.S. taxation.

INTRODUCTION

The State Department estimates there are 9 million U.S. citizens living outside the United States. Unfortunately, we suffer from the stubborn misperception - driving the development of tax policy and regulations - that Americans abroad are all living a life of luxury in low- or no-tax countries. Research published at the behest of Congressional staff demonstrates that we live abroad primarily because a relationship, employment, education, or adventure took us abroad, and we decided to stay.² The vast majority of us are middle-class Americans, working, raising families, and retiring in countries with a higher overall tax-burden than the United States. The tax policies and regulations that affect Americans abroad do not reflect this reality, but instead penalize millions of us ordinary American citizens in attempting to foil a few bad actors.

¹ "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation" [Bit.ly/FilingFromAbroad](https://bit.ly/FilingFromAbroad)

² "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation" [Bit.ly/FilingFromAbroad](https://bit.ly/FilingFromAbroad)

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Filing taxes from abroad while navigating the convergence of the U.S. and a non-U.S. tax system is stunningly complex. Research has found that most doing so seek the services of expensive tax return preparers to produce filings that commonly show that we owe no U.S. tax.³

Democrats Abroad recognizes that the American Jobs Plan and American Families Plan – federal government spending programs essential to supporting Americans through the pandemic, rescuing the economy, and investing in our future prosperity - are going to place pressure on current and future taxpayers.

Democrats Abroad supports the aim of raising additional federal government revenue from those wealthy Americans and large U.S. corporations not paying their fair share. We celebrate President Biden's pledge not to raise taxes on those making under \$400,000 per annum. We laud the actions of Congress in advancing tax policies that treat low-income Americans differently from high-income Americans, such as the income-based eligibility criteria for receiving CARES Act and American Rescue Plan Act pandemic aid. And we strongly support the Made In America Tax Plan reforms to the 2017 *Tax Cuts and Jobs Act* that remove incentives to offshore jobs and R&D, move profits to low-tax jurisdictions, and abuse tax havens.

However, we also need Congress to address the distressing taxation predicament of working-class Americans living abroad. We need Congress to understand our community, recognize our tax problems and enact reforms to reduce the hardships we inadvertently suffer due to laws meant to deal with bad actors, not ordinary citizens.

AMERICANS ABROAD AND U.S. TAXATION

Democrats Abroad wants desperately to vanquish the persistent, apocryphal stereotype that American civilians living abroad are wealthy citizens avoiding U.S. taxes. The vast majority of us are ordinary working-class Americans, about whom our research has found:⁴

- 61% had household income less than \$100,000
- 72% were married, 71% of whom to non-U.S. spouses
- 63% owned their own home
- 32% had moved abroad for marriage or a relationship
- 25% had left the U.S. for work/employment
- 64% had made their home abroad and had no plan to return to the U.S.
- Most live in countries with a higher overall tax-burden than the U.S.

The May 12th hearing placed important emphasis on the way the tax system works differently for the wealthy than for the rest of us because it taxes wealth more favorably than work. We are pleased that Congress is debating reforms to the taxation of capital income to level the playing field. Chairman Thompson also reaffirmed the need for "tax laws to be fair on paper and fairly enforced." Our analysis of the taxation of Americans abroad demonstrates that reforms are needed on both these counts.

³ "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation" [Bit.ly/FilingFromAbroad](https://bit.ly/FilingFromAbroad) and "Can We Please Stop Paying Twice?: Reforming the U.S Tax Code for Americans Abroad" [Bit.ly/CanWePleaseStopPayingTwice](https://bit.ly/CanWePleaseStopPayingTwice)

⁴ "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation" [Bit.ly/FilingFromAbroad](https://bit.ly/FilingFromAbroad)

Tax Problems for American Families Abroad

While the *Foreign Earned Income Exclusion* and *Foreign Tax Credit* provide some protection from double taxation, **there are many types of income that fall outside those provisions and are double taxed.** These include income associated with retirees and with vulnerable citizens living on foreign government social welfare. **Some U.S. tax treaties protect savings in statutory retirement accounts from double taxation, but, as we have informed this Committee previously, most treaties do not.**

Punitive tax-treatment of non-U.S. investment and saving vehicles, combined with provisions in securities, national security, and banking laws, **make saving for retirement or the family's future very expensive and inefficient, if not impossible.** What the U.S. tax code deems a Passive Foreign Investment Company or PFIC, and thus subject to punitive tax treatment meant to discourage investment, can include standard savings vehicle for Americans abroad in the country where they live. Americans abroad very commonly stumble into this grave financial planning mistake. Unwinding investments in PFICs gives rise to an enormously complex tax filing necessitating the support of a tax advisor, the cost of which elicits further financial punishment.

U.S. investor protection "Blue Sky" laws require investment origination, sales and management firms to implement a range of provisions to protect investors. Blue Sky Laws require those seeking financial products to provide a verifiable U.S. address, in some instances more than just an address for general correspondence purposes.⁵ Complying with these laws requires **U.S. investment managers to deny U.S. financial products to Americans abroad with no U.S. residential address.** These obstacles to saving and investing both in the United States and abroad, form an intolerable hardship for families.

Even the family home puts the non-resident taxpayer at risk. Americans abroad are entitled to neither a deduction for interest on a home mortgage, nor to favorable capital gains and other tax treatments on the sale of a primary residence. In fact, they are at risk of a capital gains tax liability should fluctuations in exchange rates create an artificial gain at the time of property sale or even re-financing.

Filing U.S. taxes from abroad is inordinately complex, forcing most Americans abroad to seek the services of expensive tax-return preparers who understand the tax systems of both the U.S. and the country where they reside. On average, Americans abroad pay nearly triple what U.S.-based filers pay for tax preparation. Therefore, **most are paying heavily to maintain U.S. tax compliance even though they owe no tax** to the U.S. government.

The burden of tax filing from abroad is compounded **by foreign financial account reporting requirements.** Since the Foreign Account Tax Compliance Act (FATCA) fully implemented double-disclosure of foreign-account and financial-asset reporting - meaning that both the individual and their bank must report - 30% of Americans abroad have reported impaired access to even ordinary financial products and services where they live.⁶ This "lockout" of Americans abroad by foreign banks and financial institutions has been enormously disruptive for those affected, as noted in sworn testimony to the April 26, 2017 House Subcommittee on Government Operations hearing, "Reviewing the Unintended Consequences of FATCA."⁷

Failure to comply with FBAR reporting requirements for foreign-bank and other foreign financial-accounts carries **heavy penalties that are far out of proportion to the taxpayer lapse**, especially

⁵ <https://www.upcounsel.com/blue-sky-law>

⁶ "Tax Filing From Abroad: 2019 Research on Non-Resident Americans and U.S. taxation" [Bit.ly/FilingFromAbroad](https://bit.ly/FilingFromAbroad)

⁷ <https://www.govinfo.gov/content/pkg/CHRG-115hhrg28503/pdf/CHRG-115hhrg28503.pdf>

when, for example, it is due to ignorance borne of IRS neglect, language barriers, or lack of ability to use or to access electronic devices which are mandatory for FBAR filing.

Non-U.S. domestic partners of Americans abroad often remove their U.S. spouse from financial accounts to avoid U.S. financial account reporting requirements, **making the American vulnerable to spousal financial abuse, manipulation, or neglect.**

Americans abroad also suffer from serious deficiencies in IRS service and support. For many years the IRS has provided little to no advice to non-resident citizens about tax-filing obligations. Ignorance, misinformation, and confusion abound, even among consulate and embassy staff. In recent years the IRS has withdrawn staff from international postings and replaced them with telephone and online support that vastly underestimates how inordinately difficult it is to file taxes from abroad. FreeFile programs are not suited to non-resident filers and free support from volunteer tax return preparers available to aged and indigent taxpayers in the United States. is not accessible to those living abroad.

The unfortunate experiences of Americans abroad in accessing pandemic aid provide further evidence of the need for greater attention to our needs by the IRS. In research published in October 2020 on Americans abroad and the CARES Act, only two in three Americans abroad who were eligible for a CARES Act stimulus payment had received one. Further, 70% of those who received the aid received a check, which took on average 12 weeks to arrive and be converted into cash.⁸ IRS data suggesting 90% of CARES Act stimulus payments were distributed within two weeks clearly made no accommodation for the time it took for the cash to actually reach the hands of Americans abroad (and turned a blind eye to the often-large fees incurred for cashing a U.S. government check abroad.)

The IRS cannot currently deposit funds - e.g., stimulus payments or tax refunds - into a non-resident American's foreign bank account. Direct deposit is available for bank accounts located only in the United States. Requests by multiple Americans abroad groups to change this policy have so far yielded no response, but given that the Social Security Administration, Veterans Administration and Railroad Retirement Board have all worked out how to make payments into the non-U.S. bank accounts of beneficiaries living abroad, we are hopeful the IRS will soon work out a way too.

Most recently the IRS announced it will allow **advance payments of the 2021 Enhanced Child Tax Credit, made monthly from July through December 2021, only to eligible taxpayers who have a main home in the United States for more than half the year.** It is not clear why the IRS has decided to lock Americans abroad out of this benefit.

Tax Problems for Employees and Small Business Owners Abroad

U.S. taxation puts job-seeking Americans abroad pursuing tax-equalization **at a competitive disadvantage in the job market** as it makes them 40% more expensive for companies to hire than other nationalities.

Financial account reporting requirements make Americans abroad **very unattractive as business partners** to those averse to sending their business's financial information to the U.S. government.

The Repatriation and GILTI taxes in the 2017 Tax Cuts and Jobs Act are causing an existential crisis for Americans abroad who own small to medium-sized businesses. The reforms that ushered in these new taxes have been enormously beneficial for American companies with profits in foreign subsidiaries. But conversely, for Americans abroad, retirement savings held in their business are being drained to pay *Repatriation tax* and their current and future earnings are double taxed by

⁸ "Americans Abroad and CARES Act Aid" [Bit.ly/CARESActandAmericansAbroad](https://bit.ly/CARESActandAmericansAbroad)

GILTI; those Americans are being forced to either restructure their businesses at considerable cost or to close them entirely.

INCLUDING U.S. CITIZENS ABROAD IN TRANSFORMATIONAL REFORMS

The programs in the American Jobs Plan/Made In America Tax Plan and the American Families Plan comprise a generation-defining investment in American commercial and social infrastructure and a commitment to grow the middle-class and expand the benefits of economic growth to all Americans.

Americans living abroad manage U.S. businesses and other enterprises, promote U.S. interests and serve as unofficial ambassadors for American culture and values. They contribute to the U.S. economy, industry, foreign relations, incoming investment and cultural exchange, all of which Congress has made little attempt to understand. Americans abroad are yet another component of U.S. infrastructure that the government has neglected and in which the government has underinvested. The reforms outlined here will produce new personal and financial opportunities for Americans abroad and will ensure they are not left out of this transformational policy-making.

In order to make U.S. taxation fair for all Americans **reforms are needed to ensure that the income of ordinary, law-abiding middle-class Americans abroad is not double taxed or punitively taxed.** We propose:

- Changing to the definition of income that is included in the Foreign Earned Income Exclusion to protect the social welfare payments and retirement benefits of low-income Americans abroad;
- Harmonizing the tax treatment for primary residence homes owned by Americans living abroad with the treatment of primary residence homes owned by citizens living in the U.S.;
- Exempting Americans abroad with income under \$400,000 from the GILTI tax;
- Exempting Americans abroad with income under \$400,000 from the Passive Foreign Investment Company (PFIC) rules that apply to foreign pension plans, mutual funds and other savings vehicles;
- Eliminating taxation of artificial capital gains (and losses) when no currency has been exchanged, thus allowing the currency of the taxpayer's country of residence to be the functional currency for tax purposes; and
- Allowing Americans abroad eligible for the Enhanced Child Tax Credit to receive the six months of 2021 Advance payments as well as any future Advance payments, should Congress extend the benefit or renew it indefinitely.

In order to level the playing field for all taxpayers **reforms are also needed to make tax compliance more accessible to Americans abroad.** We propose:

- A filing exemption for Americans abroad whose income indicates they owe no U.S. tax, with a simplified earnings declaration certifying eligibility for the exemption;
- A tax credit for the cost of preparing tax filings from abroad over a threshold approximating the average cost incurred by U.S. tax filers for the cost of tax return preparation;
- Provide free e-file systems that include all the IRS electronic forms needed by non-resident filers (for such things as declaring foreign tax credits) and enable them to include electronic attachments needed for information reporting; and
- Improved IRS support to Americans abroad, including:

- staffing in locations abroad;
 - online or telephone helplines that can be reached from all countries, are toll-free and are operated by agents with expertise in the issues of non-resident filers;
 - access to volunteer tax preparation assistance for low-income and elderly filers abroad;
 - IRS portals that guarantee access for Americans with an I.P. address outside the U.S. or without a U.S. address or phone number; and
 - IRS payments systems that accommodate the non-U.S. bank accounts of Americans abroad.
- A FATCA Same Country Exception to exclude from all FATCA reporting the accounts of Americans abroad in the country where they live and already pay tax;
- Reforms to the Foreign Bank and Financial Accounts Report (FBAR):
- Index for inflation the \$10,000 reporting threshold;
 - Create a separate reporting threshold for Americans living abroad perhaps 5 times higher, similar to FATCA reporting;
 - Address the duplication of reporting on FBAR and FATCA, as recommended by the IRS National Taxpayer Advocate;
 - Address the out-of-proportion penalties for non-willful failure to disclose accounts;
 - Restore the option to submit FBAR paper filings; and
 - Provide for FBAR reporting in Spanish and other languages.

We strongly support policy to end tax avoidance. We support the elimination of tax policies that subsidize the wealthy. And we note that our suggested reforms can be structured with de minimis provisions to prevent access by high earners and those with high net wealth to ensure that they enhance existing tax enforcement mechanisms. These reforms are consistent with the goal of getting everyone to pay their fair share.

Thank you for this opportunity to comment and provide recommendations. Not since the Carter Administration has there been a hearing in the U.S. Congress on Americans living abroad and the range of serious personal and financial problems that U.S. taxation causes for them, their families, their businesses, and the U.S. and non-U.S. entities they do business with. **We re-state our belief that it is past time that the issues of Americans abroad be heard, documented in the public record, and addressed by the government.**

Thank you for your interest in these matters. Please contact Carmelan Polce of Democrats Abroad's Taxation Task Force (+61 404 767 088 or carmelan@democratsabroad.org) or the undersigned with any questions about the information and recommendations provided above.

Sincerely,

/S/

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