



AMERICAN CITIZENS ABROAD
THE VOICE OF AMERICANS OVERSEAS

ACA, a non-profit, non-partisan, volunteer advocacy association with members in over 90 countries and more than 30 years of experience, represents in Washington D.C. the interests of Americans residing overseas.

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Taxation of Americans Resident Abroad

American Citizens Abroad (ACA) proposes to streamline U.S. tax law affecting Americans abroad. This win-win solution creates new job opportunities, enhances U.S. competitiveness and raises additional tax revenue for the U.S. The ACA proposal resolves incompatibilities between citizenship-based taxation and the Foreign Account Tax Compliance Act (FATCA).

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Introduction

The U.S. debt crisis is approaching the point at which critical government services risk to be impaired or eliminated in order to service the expanding debt. Experts in both parties caution that the debt is approaching a catastrophic level, and the topic is now rightfully assuming a central place within the national political debate. Clearly, measures that are fiscally sound and prudent should be pursued if there is any hope of managing future debt levels.

To this end, it is urgent that the United States reconsider, among many issues, its tax policies towards Americans living abroad. Current IRS practices are creating more problems than they are solving. As a general rule, Americans abroad pay taxes to their local country of residence. In addition, they are subject to U.S. taxation. The combination of U.S. taxes, the onerous filing requirements under the Report of Foreign Bank and Financial Accounts (FBAR) and its shadow, the Form 8938 for reporting foreign financial assets, as well as the extremely complex and burdensome Foreign Account Tax Compliance Act (FATCA) legislation is a lethal model, making life for Americans residing overseas extremely difficult. The problems faced by the community of Americans abroad were highlighted in the December 2011 report of the National Taxpayer Advocate, Nina Olson.¹ Recent U.S. tax policies now prevent an increasing number of Americans abroad from opening and maintaining a local bank account, signing mortgages or insurance contracts, obtaining employment, and entering joint-ventures and partnerships with foreigners! These policies are forcing increasing numbers of Americans to renounce their U.S. nationality in order to function in a global society. The absurdity of this situation requires an urgent, fundamental tax reform with regard to Americans abroad.

Summary

ACA proposes that Congress introduce into U.S. tax law an alternative to citizenship-based taxation, the principle under which all Americans are taxed today, whether they are resident inside or outside U.S. borders. This policy is also applied to U.S. permanent residents (green card holders), even if they are overseas resident.

ACA proposes that Americans and green card holders who reside overseas (hereafter referred to collectively as “Americans abroad”), have the possibility, if they so elect, to be taxed by the United States on the same basis as the U.S. currently taxes non-resident foreign nationals.²

This alternative is referred to hereafter as Americans Abroad Taxation, or AAT.

In the ACA proposal, U.S. source income would be taxed through withholding taxes determined by U.S. tax law and U.S. income tax treaties. This would include withholding taxes on all U.S. source unearned income (including dividends, interest, royalties, pensions, passive rents from U.S. properties, etc.). Income earned in the United States by Americans abroad, income from participations in U.S. partnerships and compensation for self-employment services performed in the United States would be taxed, as the case may be, either by a withholding tax at source or by reporting income under the same rules that apply to non-resident aliens who have so-called effectively connected income. Investments in U.S. real estate remain subject to local real estate taxes and to the provisions of Foreign Investment in Real Property Tax Act (FIRPTA) at the time of sale.

This recommendation is totally consistent with the tax policy practiced throughout the world; it levels the competitive playing field which is currently tipped against Americans abroad.

The ACA proposal:

- produces \$35 billion in additional revenue for the United States Treasury over ten years, compared to the current system, because the United States will collect (i) withholding taxes on U.S. source income, thereby preempting tax revenue which presently goes to foreign governments under citizenship-based taxation; higher tax rates in OECD countries generate foreign tax credits that cancel most U.S. tax liability, (ii) fees and taxes related to the election of AAT, and (iii) back-taxes from taxpayers entering into compliance;
- provides anti-abuse measures;
- aligns U.S. tax policy on individuals with that of the rest of the world;
- defines the taxation of both Americans abroad and U.S. international corporations (as proposed by the Ways and Means Committee),³ on a territorial basis;
- enhances the competitiveness and export potential of the United States;
- stimulates job creation for Americans at home and abroad;
- streamlines the taxation of Americans living and working abroad;
- rationalizes and reduces the administrative burden of the IRS in a cost-effective way;
- reinforces synergies between Americans abroad and the United States.

In practice, what does Americans Abroad Taxation (AAT) mean?

In summary (details provided in sections and in Exhibits 1 and 2):

- AAT is made available as an option to Americans, including green card holders, who have established residence overseas and are not residents in a country determined by the IRS to be a tax haven (such as Belize, Cayman Islands, etc.).
- the option is exercised as follows:
 - filing the AAT Election Form
 - providing proof of being subject to taxation in the country of residence
 - paying a one-time administrative fee of \$500
 - paying U.S. taxes due up to the date of AAT election
 - paying capital gains tax on unrealized capital gains, if applicable, for taxpayers subject to the requirements of Section 877A of the U.S. tax code (see the section below, “Anti-abuse measures”, for details).
- no renewal required.
- an approved copy of the AAT Election Form would be returned by the IRS to the taxpayer for the latter to be identified as a qualified AAT taxpayer and consequently recognized as such by foreign financial institutions and U.S. withholding agents.⁴
- for most Americans abroad, the AAT Election Form is the last IRS or Treasury form to be filed during their lifetime; no further requirement to file 1040 and related schedules, 1041, 3520, 3520-A, 5471, 8621, 8865, 8891, 8814, 8938 (FATCA), TDF 9022.1 (FBAR).
- contributions to U.S. Social Security and Medicare by self-employed Americans abroad become voluntary, unless required by a Social Security agreement.
- the estate of a deceased AAT taxpayer would be subject to U.S. estate tax law applicable to non-resident aliens,⁵ i.e. all U.S. real estate and investments in U.S. securities, partnerships or corporations that exceed \$60,000 are subject to U.S. estate tax law.

- AAT taxpayers who return to the United States or who establish residence in the U.S. for the first time are automatically subject to ordinary tax rules for U.S. residents. The market value of all assets, except U.S. real estate, held on the date of resuming U.S. residence would become the cost valuation for future capital gains determination. The cost valuation of U.S. real estate remains the original cost.
- AAT would be optional. Some Americans will decide to remain under the current tax code and will not elect AAT. Executives assigned overseas for short periods of time, for example, are unlikely to elect AAT.
- The AAT option is not available to Americans residing in countries deemed by the IRS to be tax havens; they will be required to continue filing U.S. taxes under the current model of citizenship-based taxation.

Overview

Under the present tax law, the United States taxes Americans abroad on their worldwide income as if they were residents of the United States. This policy is known as citizenship-based taxation. This policy is presently applied despite the fact that bilateral taxation agreements signed by the United States formally acknowledge the preeminent taxation power of the country of residence, even to U.S. citizens residing in the other treaty country.⁶

With the exception of Eritrea, a tiny African country with a GDP less than a sixth that of Vermont, the United States is the only country to apply citizenship-based taxation.⁷ While other developed countries tax their residents on their worldwide income, they do not tax their citizens who have formally established residence outside their national borders. Some countries have various procedures for the transition phase when citizens move abroad; others have no transition requirements. The ACA proposal is similar to the Canadian system and provides for transition requirements.

US citizenship-based taxation is an anomaly in the global world. It negatively impacts not only Americans working and living abroad, but also, in a broader sense, the United States domestic economy and the competitiveness of international U.S. businesses. Citizenship-based taxation is fundamentally bad law; it is difficult to enforce and leads to unfair double taxation. It is contrary to a fundamental principle: taxation is justified by services provided; overseas residents get few, if any, services from the American government. Legal scholars and tax specialists have argued against it for both theoretical and practical reasons.⁸ The Joint Committee on Taxation questioned citizenship-based taxation in the report dated September 2011, "U.S. Taxation of Cross-Border Income".⁹

Citizenship-based taxation impacts more than just tax issues. New U.S. tax laws, in particular FATCA, create a double set of regulations for Americans working, living or retiring abroad. These laws and rules handicap Americans establishing partnerships or joint ventures with foreigners and shackle competitiveness of Americans abroad, particularly entrepreneurs. They discourage U.S. corporations from sending talented individuals abroad to represent U.S. interests and gain valuable international experience. This greatly reduces employment opportunities for Americans and creates a serious impediment for U.S. exports of both manufactured goods and business services that create domestic jobs.¹⁰

IRS enforcement of the FBAR filing requirement and the passage of FATCA legislation have devastating impacts. American citizens abroad are now being systematically excluded from overseas banking relationships, pension funds, insurance policies, business ventures, and joint bank accounts and home

ownership with a foreign spouse. The combination and incompatibilities of FATCA and citizenship-based taxation are so toxic that it is forcing increasing numbers of Americans to renounce their citizenship.

Citizenship-based taxation is a human rights issue, as it unduly punishes U.S. citizens working and living worldwide. Ironically, the United States condemned Eritrea in December 2011 at the United Nations for its citizenship-based taxation (diaspora tax).¹¹

Hence, ACA proposes that Congress provide Americans residing abroad with the option to elect AAT.

Benefits for the United States of the AAT proposal

The AAT proposal will generate benefits to the United States in three dimensions:

- Benefits to the U.S. Treasury in the form of additional revenue and reduced administrative expense. Substantiated estimates are presented in Exhibit 1 of this paper;
- Benefits to the U.S. economy, through the interplay of increased exports and improved competitiveness;
- Benefits to the American people, those residing domestically as well as those residing overseas, through the creation of new employment opportunities.

Benefits to the U.S. economy:

- American businesspeople sent abroad will no longer be more expensive than foreigners; U.S. companies will be encouraged to deploy more Americans abroad. This increases long-term U.S. competitiveness through greater knowledge of foreign markets. The need to deploy Americans overseas in today's global economy cannot be overemphasized, as the tumultuous history of tax legislation on Americans abroad has demonstrated the negative impact of U.S. tax policy on U.S. exports.¹² This impact on exports was highlighted in the President's Export Council Report of 1979¹³ and a GAO Study in 1981.¹⁴
- New domestic jobs from increased exports will increase U.S. tax revenue. Every \$1 billion of American manufactured goods exports is estimated to generate 7,000 to 10,000 domestic jobs and \$150 million in federal tax revenue.¹⁵ Every \$100 billion of additional exports, a 5% increase of exports, will generate 700,000 to 1 million new jobs and \$15 billion every year in new federal tax revenue, more than twice the current tax revenue from Americans abroad.¹⁶
- Small and medium-sized U.S. companies will face fewer hurdles when setting up foreign sales operations managed by knowledgeable U.S. staff. American overseas managers share the strategic objectives of the company and established communication channels and have full backing of top management, an important element for success. Small and medium-sized companies represent an enormous potential for increasing U.S. exports and consequently domestic jobs.¹⁷
- Encouraging U.S. and non-U.S. companies to hire Americans abroad reduces U.S. unemployment as new international job opportunities are created.
- U.S. business people and entrepreneurs working overseas will be more competitive, no longer subject to U.S. Social Security and Medicare in addition to contributions to foreign social systems and double tax reporting.¹⁸ Without tax discrimination or signature authority limitation, foreign partnerships will be greatly facilitated.

Benefits to the American people:

- AAT yields benefits to all Americans. Freedom and quality of life will be enhanced.
- Three concrete examples highlight the benefits for Americans currently resident abroad:
 - Americans abroad are freed from the unjustifiable burden of double tax reporting¹⁹, certain instances of double taxation despite application of foreign tax credits, extreme FBAR penalties, and discriminatory taxation of phantom income related solely to fluctuation in the exchange rate between their local currency and the U.S. dollar.²⁰
 - Investment in local vehicles in the country of residence, which is now barred by the burdensome U.S. filing for PFICs (Passive Foreign Investment Corporations), will become available to Americans abroad.
 - The risk of identity theft for Americans abroad disappears. An overseas taxpayer's tax return²¹ includes highly confidential, extensive personal details exposing Americans to identity theft. With the current sharp increase in identity theft at the IRS, this is a major concern to Americans abroad.²²

ACA proposal for Americans Abroad Taxation

To put the ACA proposal for AAT in a proper perspective, it is important to understand how U.S. tax law presently applies to U.S. taxpayers residing overseas (citizens and green card holders), on the one hand, and to non-resident aliens, on the other hand.

- In the first place, **U.S. taxpayers residing abroad** pay income taxes in the country of residence. Then, they file in the U.S.; on their 1040 Form they can apply the foreign earned income exclusion and housing exclusion if they have income earned overseas. They can also apply foreign tax credits²³ on earned and unearned income up to the level of the U.S. tax liability. The bottom line is: after applying the foreign earned income exclusion and/or foreign tax credits, most Americans abroad do not owe U.S. taxes, even if some of their income is U.S. sourced.²⁴ In fact, 91% of the overseas tax filers filing Form 1116 owe no U.S. taxes. 58% of those filing Form 2555 owe no U.S. taxes.²⁵ Most overseas Americans reside in OECD countries with tax rates higher than U.S. tax rates; such higher rates act as a shield from U.S. taxes. Hence, tax revenue from Americans abroad represents only 0.3% of total federal government revenues (\$2.17 trillion) collected by the U.S. Treasury in 2011.²⁶ And, if it were not for obvious cases of double taxation, the share of U.S. revenues paid by overseas taxpayers would be even lower.

For Americans abroad, U.S. tax filing is highly complicated, as foreign currencies must be translated into U.S. dollars and foreign practices and regulations must be interpreted according to U.S. tax law. To ensure compliance with U.S. law, overseas tax filers generally engage a tax accountant knowledgeable in both local and U.S. taxes. These specialists are extremely expensive; in many countries they are almost impossible to find.²⁷ Though most overseas filers owe no U.S. taxes, they end up paying significant accounting and compliance fees because of the complexity of the filings and because they receive little help from the IRS, which has reduced its customer service abroad.²⁸

- **Foreigners resident overseas** (excluding green card holders), however, are subject to U.S. withholding taxes on most types of U.S. source income, including dividends, rents, royalties, but generally not including interest on bonds and bank accounts. The statutory withholding tax rate is 30%, but it is often reduced if a double tax treaty is applicable, generally to 15% on investment income; it may include exemptions on specific items. Such reduced rates or exemptions generally apply because the primary right of taxation belongs to the country of residence.²⁹ For countries without a treaty with the United States, the entire 30% withholding accrues to the U.S. Treasury.

The irony of the present system is that foreigners pay up to 30% withholding taxes on income from their U.S. financial assets and on income flows from U.S. partnerships at rates specified under section 1446. Under the present system, on the same revenue flows, most Americans overseas do not owe any U.S. taxes because all their taxable income is shielded by foreign tax credits and the foreign earned income exclusion.

To eliminate this contradiction and for the reasons outlined below, ACA proposes that the United States allow Americans and green card holders residing overseas to elect AAT as an alternative to citizenship-based taxation. The United States would tax AAT taxpayers under the rules currently applicable to non-resident aliens earning U.S. source income. All AAT taxpayers would no longer be subject to the reporting requirements on foreign assets under FATCA and FBAR. AAT taxpayers who have no U.S. business activities would no longer be subject to reporting the IRS 1040 and other income tax forms. However, if AAT taxpayers have income effectively connected to U.S. trade or business, they would be required to file the 1040NR, as do non-U.S. persons.

In practical terms, the withholding tax system is in place, as it already operates for non-resident aliens, and it easily distinguishes nationality and residency differences. Little cost of implementation is involved and once it is operative, it provides automatic tax revenues to the United States. Administrative costs would be significantly reduced for both the taxpayers and the IRS.

As shown below in more detail, ACA is convinced that its proposal is substantially revenue positive for the U.S. Treasury, bringing in a total of \$35 billion in additional tax revenue over the existing system during the initial ten year period.

Anti-abuse measures

ACA proposes anti-abuse measures designed to prevent high net worth individuals from taking up residence abroad for the sole purpose of reducing their U.S. taxes. These measures include:

- Proof that the American citizen is subject to taxation in the country of residence at the time of AAT election on the same basis as citizens of that country;
- Countries deemed by the IRS to be tax havens, such as Belize, the Cayman Islands, etc. are excluded from AAT;
- Taxpayers must limit their presence in the United States to maintain their AAT status. The substantial presence test under section 7701(b) of the tax code currently applicable to non-resident aliens will also apply to AAT taxpayers. The substantial presence test allows, for any one year, a maximum of 182 days in the U.S. (under a closer connection exception) and an average of 121 days a year over a three year period.³⁰

- Some of the taxpayers, upon electing AAT, will be required to pay U.S. capital gains tax on unrealized capital gains. The mark-to-market procedure is already defined in Section 877A of the tax code (enacted June 17, 2008) as it applies to individuals who intend to renounce either their U.S. nationality or their long-term green card. This procedure will apply to taxpayers electing AAT who meet one or more of the following conditions:
 - total assets (not including U.S. real estate) exceeding \$2 million;³¹
 - unrealized capital gains (not including U.S. real estate) in excess of \$651,000;³²
 - average income tax over the last five years exceeds \$151,000.³³

This mark-to-market procedure, however, will **not** apply to taxpayers electing AAT (i) who have had uninterrupted residence overseas since before June 17, 2008 or for the entire five year period prior to enactment of the AAT legislation³⁴ and (ii) who have fulfilled all of their U.S. tax obligations, e.g. filing 1040 and other relevant forms and paying taxes due on a timely basis.

- Under the ACA proposal, all U.S. situs estate assets of Americans abroad who have elected AAT and who die while abroad will be subject to the rules presently applicable to deceased non-resident aliens owning U.S. assets. This provision is more favorable to the United States than the OECD model which recognizes the right of non-resident countries to impose estate tax only on real estate. All U.S. situs assets, including real estate, securities, trusts, partnerships, etc., that exceed \$60,000 would be subject to U.S. estate tax. Estate taxes paid in the country of residence of the deceased on account of U.S. assets would be creditable against U.S. estate taxes, according to U.S. law and U.S. estate tax treaties. Note, however, that the current threshold of \$60,000 over which the United States taxes U.S. situs assets of non-resident aliens is so low that it discourages foreign investment in the United States. If AAT is accepted by Congress and Code Section 2012 (b)(1) becomes applicable to Americans abroad electing AAT, ACA recommends that Congress substantially increase the threshold.
- Americans electing AAT who are subject to Section 877A³⁵ also remain subject to provisions of Section 2801 of the U.S. Tax Code³⁶ during the initial five years of overseas residency. Years of residence overseas prior to enactment of the AAT legislation count towards this five year requirement related to Section 2801.

Implementation of the AAT proposal

Implementation of the AAT proposal requires changes in the U.S. income tax code and estate and gift tax laws. A checklist is provided in **Exhibit 2** as a starting base for legislative drafting. Changes in IRS forms and procedures can be implemented by a tax rule specifying that Americans abroad who have elected AAT are subject to rules that apply to non-resident foreigners. For example, Americans abroad would provide Form W-8BEN accompanied by a copy of the AAT election instead of a Form W-9 to withholding agents.

Citizenship-based taxation vs. AAT as it affects Americans abroad

It is not a matter of paying, or not paying, U.S. taxes. ACA proposes paying U.S. taxes under a different model.

AAT facilitates the paying of U.S. taxes by Americans abroad. It alleviates the undue stress on the American community caught in the crossfire of fiscal enforcement aimed at U.S. resident tax evaders, FBAR reporting looking for criminals (money launderers, drug barons and arms dealers), and FATCA, legislation primarily aimed at tax evaders resident within the United States. At the present time, under citizenship-based taxation, bank accounts of Americans abroad are being forced to close, mortgages are being denied, securities are being parked in expensive SEC registered ghettos, spouses are being excluded from joint bank accounts with foreign spouses, entrepreneurs are being excluded from joint-ventures with foreigners, managers are being blocked in careers below signature authority level,³⁷ etc. Invasive FATCA rules are prohibiting access to foreign financial institutions and Americans overseas have their backs to the wall. Congress must come to recognize the seriousness of this dire situation and the need to remedy it.

Up to now, in order to lead “normal” lives, thousands, if not millions, of Americans abroad have stayed under the radar screen of the IRS and have not filed their 1040 since compliance from overseas is essentially voluntary, and the IRS has insufficient means to enforce tax collection abroad. Americans abroad may be aware of the tax filing requirement, but hesitate to engage an extremely costly tax professional to prepare the complex U.S. tax forms when they know that no U.S. tax is due. Many long-term overseas residents are unaware of their tax filing obligation. The IRS efforts to inform the overseas community of their duty have been sparse and ineffectual. Some, born abroad to a U.S. parent, are citizens of the country where born, have never held a U.S. passport and have never lived in the U.S. Others, born to foreign parents in the United States and thereby U.S. citizens, returned to their parents’ home country when they were infants. Still others are convinced they are no longer U.S. citizens because they had their U.S. citizenship rescinded under prior legislation, later deemed unconstitutional by the Supreme Court, thus retroactively restoring U.S. citizenship to all such persons without their knowledge or consent.³⁸ Finally, others do not earn income reaching the threshold required for filing the 1040.

The consequence is widespread confusion among Americans living abroad.

AAT does away with all of the above provided the IRS makes it easier for American citizens living abroad to become compliant. If given the opportunity to elect AAT and to become compliant without cumbersome and costly administrative procedures, without exaggerated penalties for not filing the FBAR and Form 8938 and without risk of criminal charges, Americans living abroad would be eager to normalize their situation. They would be willing to pay back taxes and related interest, if any, to do so. Americans abroad whose income is below the threshold of the U.S. tax filing requirement will also elect AAT; many stay-at-home moms married to foreigners would pay the \$500 AAT election fee in order to have family joint bank accounts and joint credit cards since FATCA restrictions on foreign bank accounts would no longer apply to Americans abroad! Electing AAT would greatly simplify the lives of Americans abroad, eliminate the burden of double filing, increase possibilities to invest with foreign partners abroad and allow access to foreign financial institutions.

In order to encourage compliance, the IRS must simplify the forms and procedures. The IRS program effective September 1, 2012 to encourage tax compliance of Americans abroad represents a step in the right direction. This program unfortunately still carries far too many restrictions and an exceedingly low

threshold (\$1,500 a year) of unpaid taxes. This will definitely prevent or discourage many individuals from coming forth. Moreover, the inappropriate term “high risk” as well as the threat of criminal charges are extraordinarily intimidating. Leery Americans abroad, knowledgeable about the mishaps under prior voluntary disclosure programs, will view the new IRS program as a trap, rather than a solution.

The U.S. Congress and the IRS must recognize the fundamental dis-functioning of citizenship-based taxation and provide the necessary framework for a practical compliance program to transition to AAT. A program that aims to encourage compliance must eliminate all threats of criminal prosecution, FBAR penalties and Form 8938 penalties. It must provide for a simplified filing procedure with no limitation for participation in the program based on the dollar amount of back-taxes due. ACA assumes that if AAT is adopted, the great majority of Americans abroad will comply with the U.S. tax system if the IRS allows a non-penalizing program for Americans abroad to become compliant. ACA estimates that 3 million Americans abroad are desperate to become compliant.

How much tax revenue will AAT bring in?

ACA estimates that AAT will be a significant revenue generator for the United States, producing \$8.6 billion annually compared to \$6.3 billion of revenue collected under the current system, i.e. \$2.3 billion more every year or \$23 billion over ten years. Moreover, ACA projects \$9 billion of additional revenue for the initial year after enactment of AAT legislation. This results from the AAT administrative fee, individual back taxes and taxes on mark-to-market unrealized capital gains of wealthy individuals electing AAT. Therefore, according to ACA estimates, the increase in U.S. Treasury revenue is \$32 billion over ten years. Reduced IRS administrative expenses leads to an estimated savings of \$3 billion over ten years, yielding a ten year total Treasury gain of \$35 billion.

These estimates are based on conservative assumptions; in fact, the program will potentially generate significantly more tax revenue. The essential part of the U.S. withholding taxes on U.S. source income is pre-empted from foreign governments. Consequently, most Americans abroad will experience little or no difference in total taxes paid.

These estimates are presented in detail in **Exhibit 1 and accompanying notes**. ACA outlines hypotheses and estimates based on available public data. The model assumes that Americans living abroad will elect AAT the first applicable year. In practice, the transition will take place over several years. In no way does this change the fiscal advantage for the United States, but only spreads it out over time.

Furthermore, U.S. exports and employment will benefit from the increased presence of Americans abroad. The ACA model does not, however, include additional tax revenue resulting from the dynamics of higher exports, new jobs created in the United States or reduced government expenses linked to lower unemployment compensation. These additional benefits to the United States are substantial.

ACA aims to have the AAT proposal scored by the Joint Committee on Taxation. The Committee’s access to IRS data and economists specialized in estimating the fiscal impact of legislation is essential in order to confirm the amount of tax revenue currently collected from Americans abroad and the positive revenue impact of AAT.

The revenue projections of the ACA proposal are based on the following estimates and assumptions:

- 4 million Americans and green card holders overseas will elect AAT, i.e. 1 million are currently compliant and 3 million are expected to become compliant. These represent 4 million taxpayers among the 12 million Americans and green card holders residing overseas: IRS estimates 7 million³⁹ Americans reside abroad; ACA estimates 5 million green card holders reside abroad.⁴⁰
- U.S. withholding taxes will apply to U.S. source income, pre-empting tax income from foreign governments to the U.S. The withholding tax is carried out within the framework of existing U.S. tax law applicable to non-resident aliens and tax treaties signed by the U.S. with OECD nations and others. U.S. source income includes financial income (dividends and interest), income from other assets (rents from a U.S. real estate), and other income (royalties, social security and pensions). ACA estimates \$1,200 per person and per year the withholding tax revenue on U.S. source income, for a total of \$4.8 billion in tax revenue.
- U.S. taxes on income earned in the United States remain in place. Americans and green card holders residing overseas who earn income in the United States would file the 1040NR, like any non-resident alien.⁴¹ 100,000 such taxpayers with an average U.S. tax of \$13,000 would yield tax revenue of \$1.3 billion. Furthermore, the AAT proposal is an option; some Americans, particularly those on short-term missions, may decide to remain under citizenship-based taxation.
- U.S. partnerships are subject to U.S. taxation following the same procedures established for non-resident aliens involved in U.S. partnerships (Form 8805). \$1.5 billion of tax revenue is projected from U.S. partnership income, based on an estimate of 50,000 AAT taxpayers with an average of \$30,000 taxes.
- Sales of U.S. real estate remain subject to U.S. capital gains tax via the withholding rules on sales under FIRPTA. Projected annual sales: 50,000 with an average capital gains tax of \$20,000 equals \$1 billion tax revenue.
- An administrative fee of \$500 paid to the IRS when electing AAT leads to \$2 billion in revenue.
- Upon election of ATT, capital gains tax will be paid on mark-to-market unrealized capital gains exceeding \$600,000 (indexed to inflation as specified in Section 877A) on all assets exceeding \$2 million, excluding U.S. real estate. ACA's estimates that 20,000 U.S. persons will be subject to tax on unrealized capital gains at an average \$200,000, resulting in \$4 billion in tax revenue.
- In total, \$17.6 billion is expected in the first year of AAT legislation. Thereafter, annual total revenues are projected at \$8.6 billion, compared to \$6.3 billion under the current system.

Moreover,

- The United States Treasury would no longer pay certain tax credits to overseas Americans, such as the make work pay, the child tax, and other credits that are claimed under the current system.
- The IRS would realize significant administrative savings as it would no longer have to process hundreds of thousands of tax returns, FBAR and 8938 forms from Americans living overseas, all of which are administratively highly complex due to thousands of pages of tax code and regulations, numerous forms, different foreign tax systems and multiple currencies. IRS savings are estimated at \$300 million annually or \$3 billion over ten years.

Conclusion

AAT provides an alternative to citizenship-based taxation for Americans and green card holders residing overseas. It would be economically advantageous to the United States in terms of fiscal revenue, employment and competitiveness.

The transition period would produce significant revenue; thereafter, on-going revenues would be higher than those under the current tax system. The United States would pre-empt from 15% to 30% on U.S. source dividends and other income that currently goes to foreign governments.

Other advantages:

- AAT significantly broadens the tax base and ensures compliance through automatic tax collection at source.
- AAT greatly simplifies application of the U.S. tax code, increases tax collection efficiency and reduces IRS administrative costs. Human and technological resources can be reassigned to drive other important IRS tasks.
- AAT allows Americans abroad to have unencumbered access to foreign financial institutions.
- AAT aligns the United States with international norms of taxation.

Finally, AAT would significantly improve U.S. competitiveness with an invigorated partnership between Americans abroad and the United States. It is in the interest of the United States to allow, even encourage, its citizens to work throughout the world on a level playing field. At a time of high unemployment, AAT provides job opportunities both abroad and in the United States. As a consequence, the United States export opportunities will increase, which leads to more domestic jobs and tax revenue.

Americans abroad represent national, economic, political and cultural interests and foster a vital international network in the world economy and on the political scene. The seven million patriotic Americans living abroad spread American ideals and play the role of ambassadors for the United States.

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Taxation of Americans Living Abroad, the ACA proposal, can be found at www.americansabroad.org. ACA, a non-profit, non-partisan, volunteer advocacy association with members in over 90 countries and more than 30 years of experience, represents in Washington D.C. the interests of American citizens residing overseas.

Comments are welcome. Please address **Marylouise Serrato** at info@americansabroad.org.

Exhibit 1: Taxation of American citizens and green card holders residing overseas

ACA Estimate for 2011
Tax Revenue under Citizenship-based Taxation
 compared to
Potential Tax Revenue if AAT is Implemented

	No. of filings	Filings with U.S. tax due	U.S. tax due (\$ in thousands)	Avg. tax due \$	Note ref.
TAX REVENUE UNDER CITIZENSHIP-BASED TAXATION					
Tax Revenue from 1040s filing Form 2555	380,286	161,900	4,849,900	30,000	a
Tax Revenue from 1040s filing Form 1116	558,900	50,300	<u>1,509,000</u>	30,000	b
Total filings and taxes	939,186	212,200	6,358,900		c
Less: Refundable Child Tax Credits paid			<u>(38,000)</u>		d
Total taxes under citizenship-based taxation			6,320,900		
TAX REVENUE IN FIRST YEAR WITH AAT					
Withholding tax on taxpayers electing AAT		4,000,000	4,800,000	1,200	e
Revenue from taxpayers under citizenship-based taxation		100,000	1,300,000	13,000	f
Tax revenue on interests in U.S. partnerships		50,000	1,500,000	30,000	g
Tax on capital gains realized on U.S real estate		50,000	<u>1,000,000</u>	20,000	h
Sub-total on-going tax revenues			8,600,000		
Fee to elect AAT taxation		4,000,000	2,000,000	500	i
Back taxes and interest paid by AAT taxpayers		3,000,000	3,000,000	1,000	j
Tax on unrealized capital gains upon AAT election		20,000	<u>4,000,000</u>	200,000	k
Sub-total first year of AAT			9,000,000		
Total tax revenue in first year of AAT			17,600,000		
IRS administrative savings			<u>300,000</u>		l
Total benefit to the United States, first year of AAT			17,900,000		

Notes to Exhibit 1

a) Source: IRS Statistics: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=132037,00.html> Number of taxpayers filing Form 1040 and Form 2555 (Foreign Earned Income Exclusion). It is assumed that 100% of those taxpayers filing Form 2555 are residing overseas. There may be some in transition between the United States and overseas, but this number should most likely be small. The latest data available for the year 2006 showed a total of 334,851 filings, of which 142,524 filings owed U.S. taxes. Total U.S. tax due was \$4,269,286,000.

To update the 2006 data to 2011, ACA has applied the same growth rate in number of filings from 2001 to 2006. The increase was 13.6% over five years.

The average tax due is \$13,000 on the total number of filings with Form 2555. The average of taxes paid for only those filings with taxes due is \$30,000; the tax due is skewed high because all those who owe no U.S. tax are not included and a small number of high income individuals pull up the average.

b) Source: IRS Statistics: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=132037,00.html> Table 3: Individual Income Tax Returns with a Foreign Tax Credit or a Form 1116. Taxpayers filing Form 1116 totaled 2,789,002 in 2006 (latest data available). They paid \$18.1 billion in foreign taxes. Total foreign tax credits applied against U.S. taxes amounted to \$10.68 billion. Of those filing Form 1116, 596,446 filings claimed foreign taxes against “other income” with total foreign taxes paid of \$12.18 billion. “Other income” is the category used for salaries and pensions; hence this category indicates the approximate number of Americans and green card holders residing overseas who file Form 1116; of those 596,446, 104,195 also filed Form 2555. To avoid double counting with the report under Form 2555, ACA has deducted the 104,195 from 596,446 to obtain 492,251 (rounded to 492,000) as the estimate of the Americans and green card holders residing overseas who file only Form 1116 in 2006.

The 2006 figure has been increased by 13.6% (following the same logic identified under a) for Form 2555) to approximate the number of Form 1116 filings from Americans and green card holders residing overseas in 2011, i.e. 558,900.

In its 2011 Report to Congress on page 155, the Taxpayer Advocate Service reported that in tax year 2009, “After the application of the Foreign Tax Credit, only 9% of these taxpayers had a U.S. tax liability.” (<http://www.irs.gov/advocate/article/0,,id=252216,00.html>). Therefore 9% of the estimated number of Americans and green card holders residing abroad filing Form 1116 has been taken for the number of filings with U.S. taxes due, i.e. 50,300 filings. Table 1116 does not allow an average calculation of U.S. taxes paid as there is no split in revenue between U.S. residents and overseas residents. To estimate the U.S. taxes paid by Americans abroad filing Form 1116, the average figure of \$30,000, determined for those filing who owe taxes with Form 2555 from statistics available, has been applied. This figure is probably significantly overstated as the United States has right only to the tax revenue related to the differential between U.S. tax rates and foreign tax rates, if the U.S. rates are higher. In fact, the average of taxes paid on all 558,900 filings of 1116 from overseas is only \$2,700.

c) The Taxpayer Advocate Service states on page 151 of its 2011 Report to Congress: “IRS data show that 858,760 taxpayers filed returns from a foreign address in calendar year (CY) 2009”. In the ACA table, the estimated total of 2011 taxpayers filing returns from abroad is 939,300, which is 80,540 or 9% more than the 858,760 figure provided by the Taxpayer Advocate Service for the year 2009. This suggests that the ACA estimate is within the ballpark with regard to total overseas filings.

d) Americans overseas with low income have the right to claim a refundable child tax credit of \$1,000 per child. In 2006 in the statistics of Form 2555, 127,700 filings had average salary income below \$41,600. A conservative estimated that 30% of those filings or 38,300 filings claim on average 1 child tax credit gives total credits of \$38.3

million. This estimate does not include other tax credits which can be claimed under citizenship-based taxation as no public data is available.

e) The estimated average of taxes withheld per AAT taxpayer is \$1,200. IRS statistics show an average of \$300 for foreigners filing form 1042-S in 2009 for withholding taxes. It is expected that the population of Americans abroad would have closer ties and more affinity to the United States as well as more knowledge of U.S. investments and would therefore hold a higher percentage of U.S. securities in their investment portfolios; they would also have U.S. source pensions and other U.S. passive income. The \$1,200 is derived from the following assumptions:

- Financial assets of U.S. persons residing abroad contain on average \$100,000 in U.S. financial assets, including shares, bonds, etc.
- Financial assets yield on average 3%, namely \$3,000 per year.
- Net withholding tax rates on U.S. source income after rebates provided by international tax treaties will average 20%, for an amount of \$600 per U.S. person per year (\$3,000 x 20%).
- In addition, an average amount of \$600 per person per year is projected for taxes on other U.S. source income, including rent, patents, royalties, pensions, etc.

IRS statistics of U.S. withholding tax on foreign-owned U.S. source income for 2009 (Form 1042-S) are provided on Table 2 at: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96993,00.html> . The table shows the following information for individual foreigners; the average tax withheld per form is \$300 (796,563,000/2,656,106).

Number of forms	2,656,106
U.S. tax withheld (in thousands)	796,563
Total U.S. source income (in thousands)	10,923,300
Principal types of U.S. source income:	
Interest	3,058,736
Dividends	1,597,838
Rents	692,658
Social Security	1,629,765
Personal Services	1,187,781
Notional contracts	174,973

f) Since electing AAT is an option under the ACA proposal, there will always be some individuals residing overseas who prefer to remain subject to citizenship-based taxation. Those who reside overseas for short periods of time may find it simpler to remain subject to U.S. citizenship-based taxation. Others may have family or business reasons requiring more than 121 days presence in the United States every year. Some Americans overseas may have earned income in the United States and would therefore be required to file the 1040NR. \$13,000 is used as the average tax paid by those still filing under citizenship-based taxation. This average is based on the 2006 data when \$4.85 billion in taxes were collected from a total of 380,285 filers of Form 2555 as highlighted under note a). If the average figure is in fact closer to the \$30,000 average of only those filing Form 2555 who owe taxes, the positive impact on revenue produced under AAT would be significant.

g) In 2008 (the latest data available) tax income on foreign recipients of U.S. partnership income amounted to \$5.3 billion. It is expected that some Americans abroad would have interests in similar ventures. Tax revenue for U.S. partnership involving Americans overseas is estimated at \$1.5 billion, based on 50,000 taxpayers with an average tax of \$30,000. Source: IRS statistics – Form 8805: Table Foreign Recipients of U.S. Partnership Income 2008 U.S. Income and Tax Withheld as Reported on Form 8805 by Country of Residence.

- h)** Americans residing abroad electing AAT would still be subject to U.S capital gains on the sale of U.S. real estate. 50,000 sales are estimated with an average capital gains tax of \$20,000.
- i)** 4 million taxpayers, 1 million already compliant and 3 million expected to become compliant, are projected to elect AAT, leading to \$2 billion in administrative fees at \$500 per taxpayer. If the fee is set higher, AAT will be even more revenue positive.
- j)** It is assumed that the 3,000,000 overseas residents who become compliant for the first time in order to elect AAT have on average \$1,000 of back-taxes and related interest due. This estimate is conservatively low. Higher back taxes collected will favorably impact revenue collected under AAT.
- k)** If there are 4 million taxpayers resident abroad, the wealthy 1% with assets exceeding \$2 million (excluding U.S. real estate) would represent 40,000 taxpayers. Half of this group is assumed to elect AAT and pay the tax on unrealized capital gains. Average total assets are estimated to be \$5 million, unrealized capital gains to be \$1.34 million. At 15% capital gains tax rate, the average tax due is \$200,000.
- l)** The savings for the IRS is based on an estimate of 3,000 employees at an average cost of \$100,000, giving \$300 million a year or \$3 billion over ten years.

Exhibit 2: Implementation of the ACA proposal

The implementation of the ACA proposal requires numerous, though not onerous, changes to the U.S. tax code. The present Exhibit 2 provides a list of the changes required and of the issues which need to be addressed.

The definition of “non-resident” alien, found at IRC §7701(b)(1)(B) is amended to include citizens and green card holders who elect AAT (i.e. to be treated as residents of a foreign country).

The definition of U.S. taxpayers is revised to be U.S. citizens and foreign permanent residents (green card holders) who have not elected AAT.

The Department of the Treasury (or the IRS) shall establish a clear set of criteria to identify and establish a list of tax haven countries where American residents will not be eligible for AAT. This list will include such obvious cases as Belize where tax laws have been designed to attract rich foreigners with fiscal privileges. The criteria for determining a tax haven, however, needs to take due account of differences in tax systems, such as countries, for instance in the Persian Gulf, where excise taxes on oil or minerals substitute for income taxes and which are not *prima facie* tax havens. Nor are other countries, where very high indirect taxes, such as VAT or high social security taxes or payroll taxes lead to low income tax rates, *prima facie* tax havens. The non-existence of a U.S. tax treaty with a foreign country should not be, a priori, a determinant criteria for labelling a country a tax haven; for instance, the U.S. does not have a double taxation treaty with several South American countries, including Argentina and Brazil, that have established tax systems and are increasingly relevant for U.S. exports.

Section 877A(g), which currently concerns only “expatriates” and “covered expatriates” (taxpayers who renounce their U.S. nationality) is amended to include two new definitions – “U.S. persons electing AAT” and “U.S. persons electing AAT subject to tax on unrealized capital gains”.

When electing AAT, Americans abroad are required:

- to file with the IRS an ATT Election Form. This form needs to be created. It would be modelled on IRS Form 8854 (Initial and Annual Expatriation Information Statement) but adapted to the specific conditions related to election of AAT. The AAT Election Form must annex a signed statement by the fiscal authorities of the country of residence recognizing that the American abroad is a resident and subject to taxation. The IRS may want to develop a standard form for the foreign governments to report the tax status of Americans abroad. The United States may need to negotiate with foreign governments to develop a convenient form;
- to pay, if applicable, capital gains tax on unrealized capital gains under the same rules specified in §877A(g)(4) of the tax code for mark-to-market evaluation of assets, adapted to AAT.⁴² §877A(g)(4) needs to be amended to accommodate the exclusion of U.S. real estate in determining the threshold of \$2 million or in valuing unrealized capital gains the valuation of assets for AAT; payment delay must be specified;
- to pay an administrative fee of \$500 to the IRS when electing AAT;
- to accept that visits to the United States be determined by the regulations for non-resident aliens, set out in section 7701(b) of the tax code. The substantial presence test allows a maximum for any one year of 182 days in the U.S. and an average of 121 days a year over a

three year period; the definition of individuals subject to the substantial presence test needs to be adapted to include AAT taxpayers;

- to recognize the obligation to inform the IRS within a specified time framework the date of re-establishment of U.S. residence, if such occurs. This procedure needs to be defined, including how to inform withholding agents and foreign financial institutions of change in status. The AAT tax program stops on the date of re-establishment of U.S. residence and the taxpayer once again becomes subject to U.S. income tax. Upon resuming residence in the United States, the market value of the individual's assets on the date of establishing U.S. residency becomes the determinant cost value of the assets for calculating future capital gains, except for U.S. real estate which maintains its original cost value.

Upon completion of the necessary steps to elect AAT, the IRS issues to the AAT taxpayer the "AAT Certificate", recognizing the individual's overseas residence for U.S. tax purposes. This may be a section on the AAT Election Form where the IRS approves and signs the form declaring confirmation of the document as an AAT Certificate, or it may be a separate document. The AAT Certificate must state clearly that the person in question is no longer to be considered by foreign financial institutions and U.S. withholding agents as a U.S. person for tax purposes.

Clear rules must define the period within which the IRS must respond to the AAT election applicant and furnish the AAT Certificate.

FATCA regulations must state that foreign financial institutions and U.S. withholding agents are to treat the individuals holding an AAT Certificate as a non-U.S. person for tax purposes. Foreign financial institutions are not obligated to file financial information with the IRS on those individuals holding an AAT certificate.

Why U.S. real estate is excluded in determining mark-to-market

§877A was initially drafted for individuals who renounce their citizenship or green card and cut off all relationships with the United States. Americans abroad who elect AAT, however, maintain attachments to the United States through their citizenship. U.S. real estate property remains subject to local real estate taxes, withholding tax on rent, and capital gains in accordance with general international tax practice and U.S. federal and state tax policy. Since Americans abroad electing AAT are taxed like non-resident aliens, they are subject, under FIRPTA, to a withholding on the principal at the time of the sale to ensure compliance with any capital gains tax.

For most Americans, an investment in U.S. real estate, often their former home, represents a significant part of total assets. By excluding U.S. real estate in determining assets subject to capital gains tax on unrealized gains exceeding \$651,000 (indexed to inflation as defined under 877A), Americans abroad are encouraged to maintain those investments. They are not pressured to sell U.S. real estate, which does not have the same market liquidity as securities. This facilitates Americans to accept overseas assignments, which otherwise they would refuse if real estate would trigger a tax on unrealized capital gains when electing AAT. Maintaining a prior U.S. residence eases the return to the United States after completion of overseas assignments.

Estate tax

The ACA proposal on estate tax maintains U.S. taxation on all U.S. assets as determined by Code Section 2012 (b)(1), which determines taxation of non-resident alien estates. The code section needs to be changed to encompass AAT taxpayers as well as non-resident aliens.

Code Section 2012 (b)(1) states that U.S. situs assets in the estate of a non-resident alien exceeding \$60,000 are subject to U.S. estate tax. The threshold is, in fact, so low that it discourages foreign investment in the United States. The estate & gift tax exclusion for non-resident aliens was set at \$60,000 in 1988, by the Miscellaneous Revenue Act of 1988. At the time the exclusion for citizens and resident aliens (green card holders) was \$650,000. Since then, the citizens' exclusion has been increased many-fold, while the non-resident alien exclusion remains at \$60,000. **Within the framework of the AAT proposal, ACA recommends that Congress substantially increase the exemption of \$60,000 under Code Section 2012 (b)(1) as it would apply to both non-resident aliens and AAT taxpayers.**

Section 2801 was added to the U.S. tax code at the same time as Section 877A. It is a penalizing measure for individuals who renounce their U.S. citizenship. Any American citizen or U.S. resident who inherits or receives a gift from a “covered expatriate” is subject to inheritance or gift taxes on the full amount of the estate with no exemption. **Section 2801 should not apply to Americans abroad electing AAT who have resided at least five years overseas at the time of their death.** These individuals maintain their U.S. citizenship or green card, and their children most likely are U.S. citizens. The five year period of overseas residence prior to non-application of Section 2801 is an anti-abuse measure to prevent wealthy individuals from establishing overseas residence and electing AAT just prior to their death to avoid U.S. estate taxes.

Conforming amendments to U.S. tax code to implement residence-based taxation

- 1) Conforming amendments ensure that overseas residents who have elected AAT will be treated the same way that non-resident aliens are presently treated and that the existing reduced treaty tax rates would extend to U.S. persons under AAT.
- 2) As a corollary, the new law will supersede or eliminate application of the “savings clause” written in the current double taxation treaties to U.S. persons who have elected AAT in order to ensure that U.S. citizens resident abroad are treated the same way that the citizens of the foreign countries are treated.
- 3) Overseas residents who have elected AAT and who have their own businesses abroad are exempted from filing tax Form 5471 or Form 8865.
- 4) Contributions to U.S. Social Security and Medicare taxes by self-employed Americans abroad are no longer obligatory, but optional.
- 5) Overseas residents who have received the AAT Certificate from the IRS are no longer required to file Form 1040, related schedules and all other forms related to overseas investments. The following list is indicative, and by no means exhaustive:
 - 1041, U.S. Income Tax Return for Estates and Trusts
 - 3520, Annual return to Report Transaction with Foreign Trusts and Receipt of Certain Foreign Gifts (except in the case of death of a Bona fide resident overseas, in which case the return must be filed)
 - 3520-A, Annual Information Return of a Foreign Trust with a U.S. Owner

- 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations
 - 8621, Return by a Shareholder of a Passive Foreign Investment Company or a Qualified Electing Fund
 - 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships
 - 8891, Beneficiaries of Certain Canadian Registered Retirement Plans
 - 8814, Parent's Election to Report Child's Interest and Dividends (if your dependent child is also a bona fide overseas resident)
 - 8938, Statement of Specified Foreign Financial Assets (FATCA)
 - TD F 9022.1, Report of Foreign Bank and Financial Accounts (FBAR), filed with the Department of the Treasury.
- 6) Any income earned in the United States by AAT taxpayers will require filing Form 1040NR, the form used by non-resident aliens who are engaged in trade or business in the United States or who earn income from U.S. sources, including deferred compensation earned by individuals relating to work performed in the United States regardless of when paid.
 - 7) Foreign financial institutions (FFIs) will be able to treat Americans abroad who elect AAT as non-U.S. persons for reporting purposes to the IRS. FATCA regulations must specify this.
 - 8) Overseas residents who have elected AAT are not considered to be Americans with regard to SEC restrictions on foreign investments. A copy of the IRS "AAT Certificate" will provide foreign businesses and banks with proof of local residence and non-applicability of U.S. citizenship-based taxation laws and SEC restrictions on American citizens. SEC regulations need adapting.
 - 9) This listing is not exclusive. Other parts of the tax code may also have to be amended.

* * *

End notes:

¹ The National Taxpayers Advocate report can be found at :

<http://www.irs.gov/uac/National-Taxpayer-Advocate's-2011-Annual-Report-to-Congress>

² Non-resident foreigners are referred to in the U.S. tax code as Non-resident aliens or NRA.

³ Chairman David Camp of the House of Representatives Ways and Means Committee issued a press release on October 26, 2011 announcing the Committee's paper titled *International Tax Reform Discussion Draft*, which proposes territorial taxation.

⁴ U.S. withholding agents are required to collect withholding taxes and report income paid and taxes withheld on Form 1042-S information return.

⁵ The current definition of a non-resident alien for estate, generation-skipping, and gift tax purposes is a non-U.S. citizen not domiciled in the United States. This would have to be changed to include non-resident U.S. citizens and green card holders who elect AAT.

⁶ The saving clause in U.S. tax treaties denies tax treaty benefits to U.S. citizens and green card holders and a nexus clause added to U.S. treaties by treaty partners with residence-based taxation denies treaty benefits to U.S. citizens and green card holders resident in their country who are not substantially present or who do not have a nexus such as a permanent home in the United States.

⁷ Ironically, the United States joined in Resolution 2023 of the Security Council of the United Nations on December 5, 2011 condemning Eritrea for imposing a "*Diaspora tax*" on its citizens residing overseas. Citizenship-based taxation is nothing more than a tax on the American diaspora under a different name.

⁸ *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals* by Cynthia Blum and Paula N. Singer, The Vanderbilt University Law School, Vanderbilt Journal of Transnational Law, May 2008. 41 Vand. J. Transnat'l L. 705.
Tax Reform for Americans Abroad by Paula N. Singer, Tax Notes International, May 25, 2009, p. 673.
The Case Against Taxing Citizens by Reuven S. Avi Yonah, PUBLIC LAW AND LEGAL THEORY WORKING PAPER SERIES, Working paper No. 190, March 2010, Empirical Legal Studies Center Working Paper No. 10-009.
<http://www.law.umich.edu/centersandprograms/elsc/abstracts/pages/papers.aspx>
A Proposal for Taking the Complexities out of Taxing U.S. Retirement Distributions to Foreign Nationals by Cynthia Blum and Paula N. Singer, Florida Tax Review, Volume 11, Number 10, 2012.

⁹ **Joint Committee on Taxation**, September 6, 2011, (JCX-42-11) prepared for the Public Hearing before the Senate Committee on Finance of September 8, 2011, "Present Law and Issues in U.S. Taxation of Cross-Border Income", p. 93. <http://www.jct.gov/publications.html?func=startdown&id=4355>. The statement of the Joint Committee on Taxation is:

Treatment of individuals

"Although most commentary on the issues of worldwide and territorial bases of taxing jurisdiction have focused on competitiveness of U.S. companies in comparison to foreign owned companies subject to territorial systems, a shift to a territorial system could also include provisions related to the treatment of individual taxpayers. Such reform would constitute a significant departure from long-standing policies, although it would have the effect of aligning the U.S. basis of taxation more closely with that of its trading partners.

The U.S. has consistently defended its assertion of worldwide jurisdiction with respect to its citizens and residents, both in the structure of the Code and in the terms of various bilateral and multilateral agreements. To the extent the U.S. has ceded such authority in practice, it reflects acceptance of international norms in favor of relief from double taxation and the policy favoring the facilitation of employment of U.S. citizens or residents abroad.

If the broad assertion of taxing jurisdiction is to be conceded in favor of expanding territorial taxation to individuals, the scope of any such expansion should be considered. For example, the exclusion could apply only to earned income by increasing or removing caps on the foreign earned income exclusion and making the exclusion available to Federal employees. The treatment of unearned income may require revisions to the rules for determining source of such

income, and create a need for new rules to establish status as a nonresident citizen. Such rules in turn would require anti-abuse provisions, possibly modeled on rules governing tax-motivated expatriation.”

¹⁰ The dramatic and unsustainable trade deficit of the United States is highlighted in the CIA World Factbook : <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2187rank.html>

¹¹ In a speech on December 5, 2011 before the United Nations, Susan Rice, U.S. representative to the United Nations, supported a UN resolution condemning Eritrea for the violation of the Universal Human Rights of its expatriate citizens because of its levying of a tax on the income of expatriates of that country which provided funds to destabilize that section of Africa. U.N. resolution 2023 condemning Eritrea for its Diaspora tax passed with ample majority. Articles 10 and 11 state:

“10. *Condemns* the use of the ‘Diaspora tax’ on Eritrean diaspora by the Eritrean Government to destabilize the Horn of Africa region or violate relevant resolutions, including 1844 (2008), 1862 (2009) and 1907 (2009), including for purposes such as procuring arms and related materiel for transfer to armed opposition groups or providing any services or financial transfers provided directly or indirectly to such groups, as outlined in the findings of the Somalia/Eritrea Monitoring Group in its 18 July 2011 report (S/2011/433), and *decides* that Eritrea shall cease these practices;”

“11. *Decides* that Eritrea shall cease using extortion, threats of violence, fraud and other illicit means to collect taxes outside of Eritrea from its nationals or other individuals of Eritrean descent, *decides* further that States shall undertake appropriate measures to hold accountable, consistent with international law, those individuals on their territory who are acting, officially or unofficially, on behalf of the Eritrean Government or the PFDJ contrary to the prohibitions imposed in this paragraph and the laws of the States concerned, and *calls upon* States to take such action as may be appropriate consistent with their domestic law and international relevant instruments, including the 1961 Vienna Convention on Diplomatic Relations and the 1963 Vienna Convention on Consular Relations, to prevent such individuals from facilitating further violations;”

¹² **Brief history:** In 1962 Congress enacted and President Kennedy signed the Tax Act of 1962 which for the very first time subjected U.S. citizens residing outside of the U.S. to U.S. income tax, although the concept of citizenship-based taxation had been adopted much earlier. Because of concern that such taxation not destroy the willingness of U.S. citizens to relocate abroad to perform the vital function of selling job-creating American exports, this 1962 legislation included a \$35,000 Foreign Earned Income Exclusion (FEIE), which at that time amply covered the compensation paid to practically all U.S. citizens, including top management executives, deployed abroad. The object of this legislation was to tax the income of the few very wealthy U.S. citizens who were presumed to have moved abroad for the purpose of escaping higher U.S. tax rates. With the inclusion of this FEIE, American citizens, including those in top management positions, continued to accept overseas assignments. U.S. exports and the manufacturing jobs they created continued to grow while the U.S. balance of trade continued to be positive, as it had been every year since 1876.

However, late in 1976 Congress enacted and President Ford signed the Tax Reform Act of 1976 which massively increased the U.S. taxation of Americans abroad, making it retroactive to January 1, 1976. The FEIE was reduced to the first \$15,000 “off the bottom” at the lowest marginal tax rate, with all income above that amount taxed at the marginal rate that would apply had there been no FEIE. A parallel tax court decision at about that same time ruled that reimbursements of out-of-pocket expenses for tuition for dependent children’s English language education, excess cost of living, excess cost of housing, obligatory home leave, security guards in dangerous areas, and such that were the direct and inescapable result of being deployed abroad were classified as taxable income along with all “in-kind” employer supplied meals and housing in remote areas where nothing else was available. These reimbursements and in-kind income items remained tax free to US diplomatic personnel and other Federal Government employees abroad, but were defined as taxable income to private citizens.

The effect on U.S. citizens living and working abroad was an absolute disaster. Hundreds of thousands came home because they could not survive. Congressional hearings revealed that U.S. contractors, who were No. 1 in winning highly competitive bids over foreign competitor companies for foreign project engineering and construction projects, were hit with skyrocketing costs for their U.S. citizen personnel. These were labor intensive projects, where the professional expertise of U.S. citizens was a key qualifying factor in the award of these contracts. As a direct result of this Tax Act these companies, in sworn testimony confirmed by a GAO on-site task force, suddenly had employees whose U.S. tax obligation now exceeded their salaries; leaving them with less than zero on which to live. That was the end of U.S. dominance of that market as well as a significant loss in U.S. goods exports since the foreign companies whose labor costs were consequently lower replaced U.S. sources with products from their own countries. With the collapse of U.S. competitiveness in bidding on foreign engineering and construction projects and the return to the U.S. of hundreds of thousands of other expats who had always ensured a U.S. trade surplus, U.S. citizens and firms abruptly abandoned formerly profitable markets that had been rendered unprofitable by this tax legislation.

The unanticipated negative consequences of this legislation were of such magnitude that more than one year after its effective date Congress retroactively postponed the effective date from January 1, 1976 to January 1, 1977. But the damage had already been done. With no idea what Congress would ultimately do, neither U.S. companies nor U.S. citizens were willing to go back abroad to address these markets in the blind hope that Congress would somehow “make things right”. In 1975, the year before the change in legislation, the U.S. recorded the largest trade surplus in its entire history. In 1976 foreign trade shifted to a deficit. Ever since 1976 the U.S. has never again recorded a positive trade balance, and the cumulative foreign trade deficit, which began that year, now exceeds \$8 trillion and continues to increase at an average of \$1.9 billion per day.

Congress once again adopted the FEIE concept in 1981, but over the years the amount of the FEIE became a political football and has failed to keep up with inflation or economic reality. In 2006, Congress passed the Tax Income Prevention and Reconciliation Act (TIPRA), which prolonged the Bush tax cuts and introduced compensatory revenue raising measures aimed at Americans abroad. It introduced the stacking measure, which basically eliminates much of the double tax relief of the FEIE, and limited the housing exclusion.

¹³ **President’s Export Council**, “Task Force to Study the Tax Treatment of Americans Working Overseas”, December 10, 1979, stated: “Americans working overseas are essential to a viable export program. An increase in the number of Americans assigned abroad can increase our exports, reduce the negative balance of payments, enhance our country’s image, and raise employment in the U.S. Recognizing that it is in the best interest of our nation to encourage Americans to work overseas, the Task Force recommends the adoption of tax policies that are comparable to those of major competing industrial nations, none of which now tax citizens who meet overseas residency tests.”

¹⁴ **GAO (then called the General Accounting Office)**, “American Employment Abroad Discouraged by U.S. Income Tax Laws”, (ID-81-29), 1981 stated: “The competitiveness of U.S. exports in the world market has become a major national concern because of the deficit in the U.S. balance of trade that developed in the 1970s and its implications for real income and employment in the United States. This problem has the focus of major initiatives to improve Government export promotion programs and to identify and correct Government disincentives to exports.

To adequately promote and service U.S. products and operations in foreign countries, U.S. companies employ a large force of U.S. citizens abroad. There is widespread concern that tax provisions contained in the Foreign Earned Income Act of 1978 are proving a disincentive to employment of U.S. citizens abroad, and, therefore, adversely affecting exports. A GAO survey of a group of major U.S. companies having substantial operations abroad revealed that U.S. taxes were an important factor in reducing the number of Americans employed overseas.” <http://www.gao.gov/assets/140/132160.pdf>

¹⁵ This number is based on recent ratios of federal tax revenue as a proportion of GDP, i.e. 15%, Source: <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=200>

¹⁶ \$100 billion of additional exports represents an increase of 5% of total exports, based on 2011 data when total US. Exports totaled \$2.105 trillion.

¹⁷ Only a small fraction of all small and medium-sized companies are exporting. If more small and medium-sized companies can be encouraged to initiate export activities, the potential for improving the nation’s foreign trade balance and creating jobs in the U.S. is significant. Within the framework of the National Export Initiative, the Small Business Administration (SBA) is undertaking a comprehensive program to encourage more small and medium-sized companies to export. As stated on page 55 of the SBA report, http://www.sba.gov/sites/default/files/files/small_business_report_final.pdf, “With 95% of the world’s customers living outside our borders and the International Monetary Fund forecasting that over 87% of economic growth over the next five years will take place outside of the United States, there are enormous possibilities for American small businesses to sell their products and services around the globe.”

¹⁸ Totalization agreements are treaties with foreign governments that intend to ensure that social security taxes are paid to only one country in order to avoid double taxation. But the United States has totalization agreements with only 20 countries.

¹⁹ Americans abroad must file taxes in the country of residence and in the United States. U.S. forms are particularly complicated. For example, Form 1116 (foreign tax credits) generally requires professional software for accurate completion; Form 5471 is overwhelmingly onerous for small business owners under the controlled foreign corporation rules as this form was developed essentially for very large multinational companies; Americans overseas often have no control over foreign national legacy decisions involving foreign trusts and thereby can be caught up in the complicated filing of Forms 3520 and

3520A; Form 8621 for PFICs (passive foreign investment companies) is another nightmare as foreign pensions are stuck in this category and the American overseas usually has no control or choice in the matter; the PFIC filing is so complicated that some professional tax preparers refuse to take clients who require such filing.

²⁰ The United States requires Americans abroad to use the U.S. dollar as the functional currency for tax reporting purposes whereas it does allow American owned corporations overseas to use the local currency as the functional currency.

²¹ The risk of serious identity theft is high as information on the 1040, Form 8938 and FBAR include the Social Security number, revenue, taxes due, birthdate, bank account numbers, bank addresses, name and number of life insurance policies, highest maximum balance, personal investments, home address, signature, etc.

²² The sharp increase in identity theft is becoming a major concern.
<http://thehill.com/blogs/on-the-money/domestic-taxes/164391-gao-taxpayer-identity-theft-on-the-rise>
<http://www.gao.gov/assets/130/126293.pdf>
<http://www.accountingtoday.com/news/IRS-Proposed-Cut-Identity-Theft-Tax-Gap-62389-1.html?pg=1>

²³ Foreign tax credits can be applied against earned income to the extent not allocable to excluded income.

²⁴ Because of the most recent change in the section 911 exclusions introduced, many Americans abroad revoked the exclusions and now use only foreign tax credits which are exceedingly complex but which generally result in lower taxes. This change is not reflected in IRS statistics which are years behind recent tax return filings.

²⁵ In its 2011 Report to Congress (<http://www.irs.gov/uac/National-Taxpayer-Advocate's-2011-Annual-Report-to-Congress>), the Taxpayer Advocate Service reported that in tax year 2009, "After the application of the Foreign Tax Credit, only about nine per cent of these taxpayers had a U.S. tax liability", p.155. The 58% ratio of filers of Form 2555 not owing U.S. tax is based on IRS Form 2555 statistics for 2006, the latest available. (<http://www.irs.gov/taxstats/indtaxstats/article/0,,id=132037,00.html>). One reason why proportionally more taxpayers filing Form 2555 owe U.S. taxes than those filing Form 1116 is because of the low cap on the amount of foreign earned income exclusion which does not correspond to economic reality. About 10% of Americans abroad reside in countries with tax systems that are radically different from the U.S. in that their tax revenue is generated primarily or exclusively, not from taxes on income, but from very high consumption or other indirect taxes, which are neither deductible nor creditable against the U.S. tax liability. Americans in these low income tax countries cannot benefit from foreign tax credits; they apply the foreign earned income exclusion and any income earned over the foreign earned income exclusion is subject to U.S. taxation. The foreign earned income exclusion, which is \$95,100 in 2012, would exceed if \$250,000 if it had been adjusted to inflation since it was initiated in 1962.

²⁶ Source: <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=200>. In 2010, the U.S. Treasury collected \$2,162.3 billion in total revenues and the amount estimated for 2011 is \$2,173.7 billion. The 0.3% is based on ACA's estimate that total tax revenue collected from Americans abroad amounts to \$6.3 billion.

²⁷ The Gulf region, in particular, is reported to have very few professional tax preparers.

²⁸ The IRS has reduced its overseas offices to only four cities – London, Paris, Frankfurt and Beijing. Staffing in each office is minimal and access hours limited to just 3 to 5 hours a day. There is no toll-free IRS number for calls made by Americans overseas. IRS outreach is primarily via its internet site, which is not sufficient. The U.S. Consulate in Dubai turned down an offer by a tax attorney to give US tax seminars for them at no cost! They acknowledged that the information would be invaluable, but turned down the offers on grounds they could not be seen in any way to be promoting a private non-US government advisor. Other consulates no doubt follow the same policy.

²⁹ A full list of the reduced treaty tax rates by country and by type of income can be found in IRS Publication 515, starting on page 39. If full identity of the beneficial owner is known to the withholding agent, the reduced treaty withholding rate can be immediately applied. The "closer connection exception" requires submitting a Form 8840 claiming the exception; the procedure is explained in IRS Publication 519.

³⁰ <http://www.irs.gov/pub/irs-pdf/p519.pdf> U.S. Tax Guide for Aliens, Publication 519, p. 4.

³¹ U.S. real estate is excluded in determining total assets because U.S. real estate remains subject to U.S. capital gains at the time of sale as well as a withholding tax on the sale under FIRPTA, or to U.S. estate tax at the time of death.

³² In Section 877A, the amount of \$600,000 exclusion of unrealized capital gains is indexed to inflation, starting June 17, 2008. \$651,000 is applicable in 2012.

³³ The \$151,000 is applicable in 2012. The amount of tax payment is indexed to inflation starting June 17, 2008.

³⁴ June 17, 2008 is the date of enactment of the Heroes Earnings Assistance and Relief Tax Act. Section 301 of this act added Section 877A to the Internal Revenue Code. Prior to June 17, 2008, U.S. law did not have an exit tax, based on the value of unrealized capital gains.

³⁵ The reference is to Section 877A, as adapted to American electing AAT, i.e. excluding U.S. real estate in determining the threshold and the amount of unrealized capital gains, as explained earlier in the ACA proposal.

³⁶ Section 2801 was added to the U.S. tax code at the same time as Section 877A. It states that any American citizen or U.S. resident who inherits or receives a gift from a "covered expatriate" is subject to inheritance or gift taxes on the full amount of the estate with no exemption. Section 2801 should not apply to Americans abroad electing AAT who have resided at least five years overseas as the latter maintain their U.S. citizenship (or green card, as the case may be), and their children most likely also have U.S. citizenship. The five year period of overseas residence prior to non-application of Section 2801 is intended to be an anti-abuse measure to prevent wealthy individuals from establishing overseas residence and electing AAT just prior to their death to avoid U.S. estate taxes.

³⁷ FBAR regulations require that Americans report to the U.S. not only foreign financial accounts over which the individual has ownership, but also foreign financial accounts over which the American has only signature authority. The consequence is that corporations overseas do not hire Americans in positions which require signature authority over corporate accounts.

³⁸ *Afroyim v. Rusk* 387 U.S. 253 (1967) overruled the Supreme Court's own precedent and law dating from 1907 that mandated loss of citizenship for voting in an election in a foreign country. Citizenship which had been lost under prior law was reinstated automatically following *Afroyim v. Rusk*.

³⁹ IRS estimate of 7 million Americans abroad is cited in the Taxpayer Advocate Report to Congress for the year 2011, p. 151.

⁴⁰ ACA estimates 5 million green-card holders residing overseas, based on the following analysis. In fiscal year 2010, 1.2 million individuals obtained a green card as reported in the Taxpayer Advocate Service 2011 Report to Congress on page 130; at this rate, over a 20 year period, approximately 24 million individuals obtain a green card; ACA has estimated that 20% would return to their country of origin, yet maintain their green card. The proposed ACA legislation will help regularize the U.S. tax situations of those green card holders who left the United States without the type of notification of abandonment of status required to eliminate their U.S. tax obligations. These individuals may be subject to U.S. income tax obligations even though they are unable to reenter that United States as green card holders because of overly long absences from the United States, a situation that raises constitutional issues.

⁴¹ U.S. source income earned by non-resident aliens from U.S. employment cannot be readily segregated from general W-2 data.

⁴² As explained in Internal Revenue Bulletin 2009-45, November 9, 2009
Source: http://www.irs.gov/irb/2009-45_IRB/ar10.html