



# MAKING THE CASE FOR A SWITCH TO RESIDENCY BASED TAXATION

## TAX REFORM FOR AMERICANS ABROAD

Residency Based Taxation (or RBT) is a system of taxation where a nation imposes tax on income generated within its borders. Citizens of a nation with Residency Based Taxation pay tax on income in the place where their income was generated. If they live and generate income abroad then their offshore income is taxed abroad and not taxed by the nation of their citizenship.

All developed nations have a system of Residency Based Taxation except the United States. Non-resident Americans face taxation by the U.S. a) regardless of where their income is generated, b) no matter where they live (and for no matter how long they have lived there), and c) except for a limited number of bilateral treaties for the avoidance of double taxation, regardless of whether they are also taxed on the same income in their country of residence.

The U.S. system of Citizenship Based Taxation (or CBT) causes enormous personal and financial hardship for Americans living abroad. There are at least 23 separate areas of the tax code that discriminate against Americans abroad<sup>1</sup>. Americans abroad advocacy groups have been speaking to Congress for many years about remedies for these tax code injustices. Implementing Residency Based Taxation would sweep all these problems away with minimal effort required by Congress. Legislative proposals under development include robust provisions for preventing abuse of offshore residence for the purpose of tax avoidance.

Americans abroad strongly favor a switch from Citizenship Based Taxation to Residency Based Taxation<sup>2</sup> to remedy the problems outlined herein.

---

<sup>1</sup> "How to Fix 23 Tax Problems for Americans Abroad with 3 solutions", August 2019.

<sup>2</sup> "Can We Please Stop Paying Twice? – Reforming the U.S. Tax Code for Americans Abroad", October 2017.

## EXECUTIVE SUMMARY

Americans abroad are ordinary, working and middle class citizens who have made their lives outside the U.S. predominantly because love, work or education took them there. They are **not wealthy or high-earning tax dodgers** using offshore residency to game the international tax system. In fact, most live in jurisdictions with an overall tax burden that is higher than the U.S.

Citizenship-based Taxation causes **financial harm** to Americans living abroad.

- Whilst the *Foreign Earned Income Exclusion* and *Foreign Tax Credits* provide some protection from double taxation, there are many types of income that fall outside those provisions and are **double taxed**. Some of those are income types that are associated with retirees and with vulnerable citizens living on foreign government social welfare.
- Filing 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. Americans abroad pay more than twice 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.
- Punitive tax treatment for non-U.S. investing and saving vehicles combined with provisions in securities, national security and banking laws make **saving for the future (notably for retirement) very expensive and inefficient, if not impossible**.
- U.S. taxation puts Americans abroad seeking tax equalization at a **competitive disadvantage in the job market** as it makes them more expensive for companies to hire than those of other nationalities. Financial account reporting requirements makes Americans very **unattractive as business partners** to those averse to sending their business's financial information to the U.S. government.
- The Repatriation Tax and GILTI taxes in the **Tax Cuts and Jobs Act** are causing **enormous financial problems** for Americans who own small to medium sized business abroad. These taxes have been an enormous boon for American companies with overseas subsidiaries and are driving increased corporate investment abroad. Conversely, for Americans abroad retirement savings held in their business are being drained and their future earnings are double-taxed, forcing them to re-structure those businesses at considerable cost or to close them.

Foreign Account Tax Compliance Act (FATCA) financial account reporting regimes were set up to obstruct tax evasion by high net worth Americans. They impose high compliance costs on foreign financial **institutions and have caused many to "lock out" American banking and investment customers**, particularly modest earners seeking only to pay their bills and save for the future.

There is **no support from the IRS available outside the U.S.** Helplines are expensive and inconvenient to call and are manned by agents without an adequate understanding of the issue particular to non-resident filers. This adds insult to injury caused by the IRS whose outreach to Americans abroad over time has been woefully inadequate and given rise to low levels of tax compliance.

*Further detail on these matters follows.*

## TAX CONSEQUENCES FOR AMERICANS ABROAD

- **Non-resident Americans face taxation in both the jurisdiction where they live and in the United States.** The United States is essentially alone in taxing non-resident citizens on their worldwide income, putting Americans abroad seeking jobs and starting businesses at a competitive disadvantage.
- Although the *Foreign Earned Income Exclusion* ensures that a large amount of ordinary income is not subject to U.S. tax, retirement, interest and investment income do not qualify for the exemption. In fact, there are many income types left out of the exclusion. These **income streams are often double-taxed**; taxed in the U.S. as well as in the taxpayer's country of residence/where the income is generated. The *Foreign Tax Credit* (for taxes paid to another jurisdiction) often does not zero out taxes owed to the United States.
- **Types of income that are subjected to double or punitive tax treatment** include, amongst others:
  - ✓ Distributions from pensions and 401k-style retirement plans
  - ✓ Dividends, interest and all investment income
  - ✓ foreign retirement, education and other savings plans
  - ✓ capital gains
  - ✓ non-qualified non-U.S. pension plans
  - ✓ social welfare payments (aged, indigent, disability, unemployment, childcare, parental leave) from foreign governments
  - ✓ bequests to surviving foreign spouses

Americans abroad advocacy groups have been speaking to Congress for many years about remedies for these tax code injustices. Implementing RBT would sweep all these problems away with minimal effort required by Congress.

- The community of Americans living abroad suffers from the misunderstanding, the misperception and the simple ignorance of Congress (and regulators). The vast majority of the 9 million Americans abroad are ordinary, working class Americans who moved abroad in order to pursue a family relationship, an education, or a job, and decided to remain. **Research<sup>3</sup> confirms that they are not wealthy “fat cats” and “high rollers” living overseas in order to game the international tax system.** In fact, most Americans abroad live in countries with a higher overall tax burden than the U.S.
- U.S. taxpayers declare income earned abroad on IRS forms designed to capture detailed information about the source of the earnings, especially investment income. Preparing and filing these forms is stunning in its complexity. 2019 research shows 55% of non-resident filers require the assistance of a specialist tax return preparer experienced in dealing with the tax issues of U.S. non-resident Americans. These specialist services cost them more than twice what Americans based in the U.S. pay for tax filing services.<sup>4</sup> For non-resident taxpayers, **filing declarations of income earned abroad is inordinately costly, confusing and frightening, even when no tax is due.**
- **IRS outreach to Americans abroad about tax compliance has been woefully inadequate over time.** As a result, many Americans abroad – including officials in U.S. embassies and consulates - are ignorant, misinformed or confused about U.S. tax filing and reporting rules and obligations. **Americans abroad do not have easily accessible advice and support from the IRS in order to file returns accurately and in a timely manner.**
- The burden of tax filing under Citizenship Based Taxation is compounded by the foreign financial account reporting requirements that support its enforcement. The Foreign Account Tax Compliance

---

<sup>3</sup> “Tax Filing From Abroad: Research on Non-Resident Americans and U.S. Taxation”, March 2019.

<sup>4</sup> “Tax Filing From Abroad: Research on Non-Resident Americans and U.S. Taxation”, March 2019.

Act fully implemented double-disclosure foreign account and financial asset reporting in 2014. Since then Americans abroad have reported **impaired access to even ordinary financial products and services where they live**,<sup>5</sup> which seriously restricts their ability to pay their bills and save for the future.

- **Failure to comply with mandatory taxpayer-provided reports on foreign bank and other financial accounts carries heavy penalties that are far out of proportion** when the taxpayer lapse is attributable to issues like ignorance borne of IRS neglect, language barriers or lack of ability to use or to access electronic devices for filing.
- Companies that hire Americans to fill jobs in other countries normally provide extra compensation to their American employees for the purpose of meeting their U.S. tax obligations. This is known as “tax equalization” and **it makes Americans more expensive to hire than those of other nationalities and thus less competitive.**
- **Globalization and the integration of economies will continue to increase the number of Americans living abroad** enduring the burden of double taxation and complex, costly tax filing and account reporting. Discrimination and harm arising from tax, financial account reporting, banking, securities and other laws will harm a growing number of Americans families and business owners abroad.
- **Congress continues to enact laws and regulations without considering the impact on Americans abroad and that have grave, unintended adverse consequences for non-resident Americans.** The 2017 Tax Cuts and Laws Act enacted a system of “territorial taxation for corporations” that provides enormous relief to U.S. corporations that own companies registered abroad; they can now repatriate profits at a deeply discounted rate with lots of offsets that ensure very little to no tax is due. The impact on U.S. citizens abroad that own companies abroad, however, has been devastating. They often retain profits in their businesses to save for retirement. They are required to show unrecognized company profits on their personal tax filings and have no access to offsets. Repatriation taxes will devastate their retirement savings. On-going GILTI taxes will force them to close those businesses or undergo costly corporate re-structures.
- **Americans abroad are ambassadors of American culture and values and promoters of U.S. interests and business enterprise.** This is a meritorious service to the nation and not one that should be “rewarded” with discriminatory tax treatment and onerous tax and financial account reporting requirements. Americans abroad deeply resent the presumption that they are tax dodgers and money launderers.

Americans living outside the U.S. need Congress to understand that filing abroad is extremely costly, frightening in its complexity, unjust and in need of urgent reform.

Democrats Abroad has published research undertaken in January 2019 with data and testimonies that demonstrate the hardship Citizenship Based Taxation causes for Americans abroad. The report, “**Filing Taxes From Abroad: Research on Non-Resident Americans and U.S Taxation**” is available at [www.democratsabroad.org/taxation](http://www.democratsabroad.org/taxation) . It underscores the importance to ordinary American families and small business owners living outside the U.S. of a switch to Residency Based Taxation.

**We are working closely with a handful of members of Congress who support Residency Based Taxation to develop legislation.** We ask Congress to give due consideration to the proposal which will provide much needed relief to Americans abroad without creating loopholes that high net worth Americans can use to exploit offshore residence to avoid U.S. tax.

Please contact us at [TaxationTF@democratsabroad.org](mailto:TaxationTF@democratsabroad.org) for more information.

---

<sup>5</sup> “FATCA: Affecting Everyday Americans Every Day”, September 2014.