



# MAKING THE CASE FOR A SWITCH TO RESIDENCY BASED TAXATION

TAX REFORM FOR AMERICANS ABROAD

Residency Based Taxation 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 causes enormous personal and financial hardship for Americans living abroad. They strongly favor a switch from Citizenship Based Taxation to Residency Based Taxation<sup>1</sup> for these reasons.

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<sup>1</sup> "Can We Please Stop Paying Twice? – Reforming the U.S. Tax Code for Americans Abroad", October 2017.

- **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, investment income does not qualify for the exemption. In fact, there are a number of 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:
  - ✓ foreign retirement savings plans
  - ✓ capital gains
  - ✓ non-qualified non-U.S. pension plans
  - ✓ social welfare payments (aged, indigent, disability, unemployment, child) 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>2</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 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>3</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 Act fully implemented double-disclosure foreign account and financial asset reporting in 2014. Since

<sup>2</sup> “Tax Filing From Abroad: Research on Non-Resident Americans and U.S. Taxation”, March 2019.

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

then Americans abroad have reported **impaired access to even ordinary financial products and services where they live**,<sup>4</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 access to 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 obligation. 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** and enduring the burden of double taxation and complex, costly tax filing and 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 and support to U.S. corporations that own companies operating abroad; they can 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 has been devastating, as they are required to show unrecognized profits on their personal tax filings and have no access to offsets. Many will be forced 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 costly, frightening, 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 Representative George Holding who has developed a proposal and introduced a bill<sup>5</sup> to enact Residency Based Taxation.** We ask Congress give due consideration to his draft legislation 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.

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<sup>4</sup> “FATCA: Affecting Everyday Americans Every Day”, September 2014.

<sup>5</sup> <https://www.congress.gov/bill/115th-congress/house-bill/7358>