



American Citizens Abroad
The Voice of Americans Overseas

Mr. Paul Volcker
Chairman
Presidential Task Force on Tax-Code Review
The White House
1600 Pennsylvania Avenue
Washington, D.C.20500

July 8, 2009

Equitable Taxation of Overseas Americans

Dear Mr. Volcker,

We are writing to you on behalf of the overseas American community and trust that your Presidential Task Force, in its review of U.S. tax policy, will take our comments into consideration, in particular, since overseas Americans have no direct representation in Congress. American Citizen's Abroad (ACA) is a non-profit, non-partisan, volunteer association, active for over 30 years, whose mission is to defend the rights of Americans living overseas.

The current US citizenship-based taxation, which requires US citizens domiciled abroad to file and pay US taxes in addition to taxes paid in the country of residence is unique among major countries. It is bad tax policy for three fundamental reasons.

- 1) It is **unfair** as it fails to meet the basic tenant of equitable taxation: taxes paid need to relate to services provided. By necessity, major government services are provided locally, such as schools, social services, health programs, roads, police, social security, etc. Americans overseas do not benefit from any of those domestically provided services. This issue is particularly acute for the more than 70% of overseas Americans who are permanently settled overseas, living the majority of their lives abroad either because of marriage to a foreigner or professional activity. It is not uncommon that comments transmitted to ACA include such words as "outrageous", "infuriating", "devastating", "unfair".
- 2) It is **detrimental to the long-term interests of the United States** because it prevents the free movement and participation of its citizens in the global economy. Yet the free movement of US citizens throughout the world is in the long-term interest of the United States. It has obvious political, cultural, educational and economic benefits and should not be hindered by misguided tax policies. America's future leaders are not getting sufficient exposure and experience overseas.
- 3) It **inevitably leads to double taxation** of overseas Americans, despite mitigating measures in the US tax code and tax treaties, due to inherent differences between tax systems. Numerous examples can be provided of the mismatch (Annex A).

American Citizens Abroad formally requests from your Task Force the opportunity to present the case of overseas Americans before the panel. In preparation for this, please find annexed to this letter two documents providing background information.

- 1) Annex A: "Tax issues highlighted by overseas Americans and tax preparers – a survey by American Citizens Abroad, June 2009."
- 2) Annex B: "Tax Reform for Americans Abroad" by Paula Singer from *Tax Notes International*, May 25, 2009 pages 673-678. This article captures most of the issues facing overseas Americans.

Thank you for taking the time to review the major tax issues facing Americans overseas and for moving forward the Administration's commitment for leveling the playing field. We hope that your objective review will override the long-established misconstrued policies of Congress with regard to Americans residing overseas.

Sincerely yours,

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Executive Director

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Director

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Congressman James McGovern
Congressman Gregory Meeks
Congressman James Moran
Congressman Donald Payne
Congressman Gregorio Sablan
Congresswoman Janice Schakowsky
Congressman Joe Sestak
Congressman Chris Van Hollen
Congressman Henry Waxman
Congressman Frank Wolf
Congressman David Wu

Annex A

Tax issues highlighted by overseas Americans and tax preparers A survey by American Citizens Abroad – June 2009

The comments presented here on the need to improve the US tax code with respect to Americans abroad reflect not only the opinions of most Americans overseas but also about a dozen US tax professionals, specialized in international tax, who work on a regular basis with US citizens residing overseas. These experts generally have between 20 to 35 years of practical experience, have written many journal articles and have prepared training material for IRS agents. They were asked a simple question:

Based on your experience and professional opinion, please list the top five things you believe should be changed or eliminated from the current tax code that would put American's living overseas on a more even playing field with respect to people living and working in the US, and also with respect to other expatriate workers of other nationalities overseas.

It is clear that the optimum solution is for the US to revert to residence based taxation. If this optimum step is unacceptable to the Administration and to Congress, many substantial changes are required in the current tax code to alleviate the serious tax stress on middle-class Americans abroad. The rest of this Annex will be in bullet point format to be brief. Upon request, ACA would be pleased to go much deeper into any individual topic.

Residence based vs. citizenship based

1. The US is the only major country in the world to tax on a citizenship basis rather than a residency basis. This causes tremendous complexity for negotiations between the US and its trading partners, for individual US persons overseas and for anyone entering the US to work.
2. It would be fairer for Overseas Americans and Green Card Holders if the US Congress were to adopt residence based taxation (which is standard throughout the industrialized world) or, at a minimum, to adopt tax law changes to place overseas Americans on the same playing field as other nationalities living abroad.
3. With an estimated 5 to 7 million US persons living overseas, there is no direct representation in Congress though there is direct taxation on worldwide income. It is very challenging for taxpayers to get their voices heard in Congress. Over 70% of US citizens resident overseas are domiciled abroad long-term, having married a foreigner or having developed a career abroad. They do not benefit from the services provided by the US government to US domestic residents – schools, healthcare, social services, roads, police, housing programs, etc. They pay taxes in the country of residence for government services.

Double taxation

4. The current tax code does lead to double taxation on a significant share of the income that US citizens earn overseas, despite tax treaties and Section 911 aiming to mitigate it. A clear indication of this is that Americans filing Form 2555 for the foreign earned income exclusion paid \$4.2 billion in taxes to the US in 2006.
5. Double taxation is due to inherent incompatibilities between US and foreign tax systems and the fact that certain foreign taxes are not recognized by the US as income taxes. This double taxation in conjunction with high social security charges abroad and significantly higher indirect taxes in principal industrial countries (VAT and gasoline taxes) leads to overall higher taxation of US citizens overseas compared to those in the United States. Over 85% of the overseas US citizens filing Form 2555 are resident in high tax countries, including most of

Western Europe, Canada, Japan, etc. Less than 15% reside in such obviously low or no tax countries as the Caribbean or the Gulf countries, Hong Kong, Monaco, etc.

6. The current tax code is the result of Congress opportunistically increasing taxes on Americans abroad to compensate for domestic tax reductions. TIPRA is a prime example. Over the ten years from 1996 to 2006, the number of Americans filing Form 2555 increased by only 20% while the taxes paid to the US increased by 97%, reaching \$4.2 billion in 2006.
7. Self employed people in many countries are required to pay both their resident country's social security charges and US social security charges (including US Medicare) even though they can not use Medicare benefits overseas. Americans overseas on modest pensions who supplement their income with a small self-employed business find their US taxes substantially increased due to the self-employed tax.

Complexity of filing

8. The tax code for US citizens living overseas is far too complex, much more so than for people living in the US. The number of forms and pages of instructions are double those for Americans residing in the United States. Most overseas taxpayers are obliged to use the services of professional tax preparers. Consequently, the cost of compliance is often significantly higher than the cost of compliance for taxpayers domiciled in the United States and is disproportionate to the amount of taxes due.
9. The foreign tax credit is too complicated and limiting. Overseas filers often do not get the full credit for overseas taxes paid because of the limitations built into the credit and the incompatibility of some overseas taxes with the US tax code, for instance the wealth tax.
10. US people who start companies overseas are required to file incredibly difficult forms (5471), so difficult that even the IRS staff says that they are not permitted to answer questions related to the forms.
11. The reporting burden for Americans abroad owning businesses translates into filling out the complex controlled-foreign-corporation forms. These forms are really aimed at nailing Americans still in the US setting up corporations or holding companies abroad to avoid taxes. They are arcane and obscure, and they generally result in zero tax due for Americans owning regular businesses abroad. Nevertheless, finding help filling them out is difficult, and the tax preparer experts ask for rates starting at \$5,000 to do this, with the rates going up depending on the complexity of the corporation's dealings. Spending this kind of money just to be in compliance is of course an onerous burden, especially if the corporation is not yet making a substantial profit, or worse, a loss. Severe penalties are listed in the IRS code for failure to fill them out or failure to do so correctly. One very simple improvement to the tax code which would be revenue-neutral and would immensely simplify the lives of American business people abroad would be to remove the CFC-form filing requirement for Americans who (1) live abroad and (2) run businesses in the same country where they live.
12. Overseas US citizens with a non-citizen spouse have additional complexities and tax burden, often being forced to choose the tax status of "Married filing separately" to exclude the spouse's foreign income from the reach of the IRS, which negates a lot of other benefits deriving from the "Married filing jointly" election.
13. The IRS provides totally inadequate support for overseas tax filers. Please refer to "Access to the IRS by Individual Taxpayers Located outside the United States" by The Taxpayer Advocate Service, 2008 Annual Report to Congress, Volume One.

Pension issues

14. Stop treating foreign pensions as taxable assets. Many foreign countries with which the US has treaties recognize US pensions. US people often have a double taxation issue with

pension, which is what the treaties are supposed to avoid. There is taxation by the US on the employer's contribution to the pension fund as well as the employee's contribution and then there is taxation by the foreign country and by the US when the pension is distributed. By not allowing most foreign pensions to qualify for US retirement benefits, Americans abroad can not defer the tax on contributions to the overseas pension plans as they would be able to do if they had remained in the USA.

15. Certain US double taxation treaties, for example with Great Britain, allow foreign earned pensions to be taxed only once, based on residence. The residence based taxation of foreign earned pension benefits should be generalized in the U.S. tax code.
16. Pension accounts should be excluded from FBAR filing.

Americans are not competitive

17. US tax policy encourages US companies to set up operations overseas but encourages them **not** to hire US citizens overseas since US workers with expatriate benefits are by and large much more expensive to employ overseas, as benefits for US citizens overseas such as educating their children in international English language schools and trips back to the US are taxable benefits to the individual. Many international companies try to make expatriate assignments tax neutral, which adds even more tax burden. A US manager or technical expert can be two to three times more expensive to hire overseas than a non-American of equal rank and skill, whether the company be American or non-US. Consequently, the American with an expatriate package is a dying breed. If an American is sent over on an expatriate package, the duration of the mandate rarely exceeds three years, as the compounding US tax cost is prohibitive. Hence, insufficient numbers of American managers, professionals and leaders are gaining international experience and contacts.
18. The FBAR requirement for Americans overseas to file for every account over which they have signature authority, even those over which the individual has no personal financial interest, shuts out overseas Americans from jobs abroad with such signature authority over company accounts. Most employers will not authorize an employee to divulge such confidential corporate information. The FBAR also discourages Americans from voluntarily serving on behalf of charitable organizations overseas.

Section 911 of the Tax Code is totally out of phase with reality

19. The foreign earned income exclusion in Section 911 of the US tax code is too low. Not only should the base amount be at least double its current level (opinion of several tax preparers), it should be indexed to the dollar's strength or weakness compared to a basket of currencies as well as to the US inflation rate. With the declining dollar, overseas Americans salaries are artificially inflated when translated into dollars for US tax purposes.
20. The foreign housing exclusion amounts do not reflect reality. Instead of having arbitrary caps in over 300 different locations which leads to a zip code lottery for overseas Americans, why not simplify whereby Treasury determines the most expensive rental cap in the world and Americans overseas can exclude the lower of their actual rental costs or the maximum cap determined by Treasury?
21. Tax rates should not be calculated after adding back the foreign earned income and housing exclusions; this negates the value of the exclusion. Most Americans are already paying foreign taxes at the highest marginal rates, so to charge US taxes at the highest marginal rates is not equitable, particularly since overseas Americans face significantly higher indirect taxes.
22. The time limits for being in the US are very disruptive to many people who work overseas while the bona fide residence test is cumbersome and uncertain.

Functional currency

23. Americans domiciled long-term overseas should be permitted to choose the currency of their domicile as a functional currency for the calculation of investment gains, just as American corporations overseas are allowed to use a functional currency. Without the option of a functional currency, overseas Americans are unduly penalized by US taxation on fictive gains resulting from the devaluation of the US dollar.

IRS Misuse and Abuse of the FBAR

24. The FBAR (Foreign Bank Account Forms) were meant as an anti-terrorist / anti-drug crime tool. Presently the rules are being unfairly applied to Americans who live overseas and have pension accounts, accounts that temporarily hold proceeds of a home sale, etc. The criminals that the government is trying to catch will never file an FBAR and the Department of Treasury's lack of clarity on this decades old requirement is an embarrassment.
25. The current limit of \$10,000 is out of date and should be at least \$50,000. Overseas Americans need bank accounts in local currency for their daily needs.
26. Incorporate the information that is really needed into the regular tax reports, and if taxpayers file all of their income properly, there should NEVER be cause for a penalty for not filing an FBAR. As one tax preparer stated:

"The new rules on reporting foreign bank accounts and the draconian penalties are absurd in my view and border on an invasion of privacy. I am very disturbed to think that generally honest Americans overseas that had no idea this form existed are being faced with the possibility of huge fines for not reporting the existence of an account overseas that may not even have generated much income—perhaps a few dollars in interest every year."

27. Americans are already being shut out of posts overseas with responsibilities including signature authorization on corporate accounts because of the far reaching new FBAR reporting requirements extending to all accounts over which one has signature authority, regardless of ownership. This cuts Americans off from leading positions in the global economy.

Perception

28. Living overseas is akin to being guilty until proven innocent in the eyes of the IRS and some members of the U.S. Congress. This is the general perception of everyone surveyed who lives overseas. As one stated: *"Stop making Americans who are fully complying with US tax laws feel like criminals just because we have bank and financial accounts outside of the United States"*. (Senior tax advisor at Big Four Accounting firm overseas)

US Tax Rules repel foreign investors and foreign talent

28. US estate tax law discourages foreigners from investing in US companies. US Estate tax (at 45%) is due on amounts over \$60,000. This is an old limit that has never been indexed. When foreign investors discover the existence of this law, by reflex, they avoid owning stocks in any US companies. This also discourages foreign investors from using US brokerages and banks unless they set up foreign entities.
29. US Tax policy scares away foreign executives and entrepreneurs from coming to the US. If someone wealthy moves to the US, gets permanent residency, and then decides to give it up, the exit tax is a major penalty, hence deterrence.