Re: "How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment." Hearing March 25, 2021

Date: March 30, 2021

Submission on behalf of Stop Extraterritorial American Taxation (SEAT)

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About SEAT – Education To Facilitate Change

Stop Extraterritorial American Taxation (SEAT) is an independent, nonpartisan organization with no affiliation with the tax compliance industry. The mission of SEAT is to provide an educational platform for individuals, policymakers, governments, academics, and professionals about the terrible effects of US extraterritorial taxation. The imposition of US taxation on the residents of other countries damages the lives of the affected individuals and siphons capital from the economies of other nations while eroding their sovereignty.

While SEAT is created under the laws of France (Law of 1901), it is an international organization.

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Submission From SEAT

Please accept this as our submission with respect to the subject of the March 25, 2021 Senate Finance Hearing: "How U.S. International Tax Policy Impacts American Workers, Jobs, and Investment."

The Witnesses – Some General Comments

First, it was disappointing that the Committee failed to include any witnesses who actually "live the experience" (corporations or individuals) of carrying on business outside the United States.

Second, the language of some of the witnesses could hardly be described as reasonable or objective. Of particular note was the constant use of the emotively laden term "offshore" to describe the activities of U.S. companies who carry on business activities outside the United States. (The word "offshore" has generally a negative connotation. https://www.quora.com/Does-the-word-offshore-gives-outsourcing-a-bad-name).

The fact is that companies based in the United States may have business operations that take place outside the United States, for the purpose of selling into markets outside the United States and for the purpose of earning profits outside the United

States. The term "offshore" suggests that U.S. companies are carrying on activities outside the United States for the purpose of avoiding U.S. taxation.

The form of the business activity: Directly or through a foreign corporation

In some cases, U.S. companies carry on business outside the United States as a U.S. corporation. In other cases, U.S. corporations may create a subsidiary foreign corporation**. GILTI income exists only in the context of carrying on business through a foreign corporation that is controlled by one or more U.S. Persons. Therefore, the discussion of GILTI at its core, is a discussion of how the United States should impose taxation on non-U.S. companies, earning non-U.S. profits, earned outside the United States.**

The Nature of GILTI Income

The title of the hearing suggests a focus on **how the effects of U.S. International Tax Policy Impacts American Workers, Jobs and Investment**. The focus was to be on the effects on individual Americans. Yet, the hearing itself was a referendum on the 2017 TCJA in general, and the GILTI provisions found in Internal Revenue Code 951A in particular. Although not articulated by any of the witnesses, it is important to understand that S. 951A is part of the Subpart F regime. Subpart F, created in 1962, is a set of rules designed to attribute income earned by foreign corporations to the individual shareholders of the corporation. Under applicable circumstances, income earned by the corporation, is attributed to the shareholder, when the shareholder has NOT received a distribution from the corporation. To put it another way: the shareholder pays tax on income at the time it is earned by the corporation and before that income is distributed to the shareholder. These rules apply whether the income is ever distributed to the shareholder.

It was disappointing that not a single witness described the GILTI rules in a way that drew attention to the fact that GILTI income is earned by a separate corporate entity and is NOT earned directly by the U.S. shareholder. The failure to acknowledge this left the impression that the issue was whether there should be a preferential tax rate on foreign income earned by U.S. multinational corporations. The discussion should have clarified that the discussion was really about how the United States could impose U.S. taxes on the non-U.S. profits of foreign corporations (by taxing the shareholder instead of the company). (The United States has no jurisdiction for – and treaties prevent – the United States imposing direct taxation on non-US corporations.)

In short, the nature of GILTI income is that: the U.S. shareholders of certain non-U.S. corporations are required to pay U.S. tax on the profits earned by those corporations, when they have not received income from that corporation. Rather than enhancing the understanding of that basic principle, the witnesses obscured that principle.

The Two Kinds Of Shareholders Subject To GILTI (Corporate and Individual)

The GILTI tax applies to the "U.S. shareholders" of controlled foreign corporations. It imposes tax obligations on those shareholders. Both individuals and corporations can be "U.S. Shareholders" of CFCs. The hearing did not contain a single acknowledgement that individuals (the presumed beneficiaries of the hearing), could (as a result of the GILTI rules) be forced to pay personal tax on income earned by a corporation. The hearing focused completely on corporate shareholders of foreign corporations and not individual shareholders. Shouldn't the reality of individual shareholders have rated at least a "mention" in the discussion?

Individuals matter. The issue is and should have been (as was implied by the title of the hearing) how international taxation impacts individuals. The fiscal status of corporations affects individuals indirectly. But, international tax provisions like GILTI have a direct effect on individuals.

The Two Kinds Of Individuals Subject To GILTI (Resident Americans and Americans Abroad)

As evidenced by the content of the hearing, the U.S. tax system has special rules (generally punitive) for income streams and reporting of assets that are foreign to the United States. One clear example of the taxation of foreign income is the Subpart F regime (income received by U.S. shareholders of non-U.S. corporations which includes GILTI). An example of reporting would be the Form 5471 seeking information about both the corporation and the shareholders of affected non-U.S. corporations. When applied to "individuals" (who are shareholders of CFCs) both the treatment of profits earned by the CFC and the reporting of information about the CFC are generally punitive. (Would you like to pay tax on income earned by a corporation but was never distributed to you?) The effects on individuals who are resident in the U.S. are very different from the effects on Americans abroad who are also tax residents of other countries.

Both individuals and corporations are subject to the Subpart F regime and GILTI. It is shocking that certain provisions of the Internal Revenue Code treat individual shareholders of CFCs more punitively than corporate shareholders of CFCs. The worst treatment is reserved for **individual** Americans abroad, who are entrepreneurs, **carrying on business through a corporation in the country where they live.** For Americans abroad, their small business corporations, which are foreign to the United States, are local to them. "Offshoring" applied to these U.S. Shareholders is particularly inaccurate. Such is the effect of the uniquely American penchant for defining tax residency in terms of "who you are" (citizenship) rather than "where you live and consume services" (residence).

About “citizenship-based taxation”- The US extraterritorial tax regime

The United States has the following three distinct tax regimes:

1. **Source – like all countries:** All income sourced to the United States is subject to U.S. taxation on U.S. source income (regardless of the “tax residence” or citizenship of the taxpayer);
2. **Residence – like all countries:** All individuals who are resident in the United States are subject to U.S. tax on their worldwide income; and
3. **Extra-territorial tax regime – unique to the United States**: The United States imposes worldwide taxation on the non-U.S. source income of certain individuals, who are tax residents of other countries and do NOT reside in the United States. This includes U.S. citizens living outside the United States.

Americans abroad are generally in the third category and are subject to the extra-territorial tax regime. They are subject to worldwide taxation by **both** the United States and their country of residence. Americans abroad do NOT as a general principle benefit significantly from tax treaties. This is because, all U.S. tax treaties contain a “saving clause” designed to ensure that Americans abroad are in effect subject to double taxation.

Who Are Americans Abroad?

The short answer is that Americans abroad are U.S. citizens living outside the United States in other countries. They run the whole circumstantial and economic spectrum of humanity. They include the poorest of the poor. They include some wealthy people. They include a large number of middle-class people. They include the employed, the self-employed and they include the unemployed. They include individuals who run small businesses in their country of residence. Some of these small businesses are run through corporate structures in the country where they reside and are tax residents.

Although Americans abroad are Americans who live in other countries, **they are NOT and do NOT view themselves as “living offshore”!**

Americans abroad – Small Business Corporations And The Extra-territorial tax regime

Different countries have different tax systems. Tax systems have different purposes. These purposes include: generating revenue for governments, distributing benefits to taxpayers and creating incentives for responsible retirement and financial planning.

In some countries (Canada for example) small business corporations play the role of being private pension plans for self-employed individuals (who are not otherwise eligible for pensions). Generally speaking, this is because tax laws (as they do in Canada) allow for the deferral of limited income inside those corporations. Notably these “Canadian Controlled Private Corporations” “cannot be controlled by one or more nonresident persons” (guaranteeing that their tax benefits are enjoyed

overwhelmingly by residents of Canada). (See https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/type-corporation.html#ccpc).

The 2017 TCJA and Americans Abroad With Small Business Corporations

The 2017 TCJA added both the S. 965 Transition Tax and S. 951A GILTI provisions to the existing Subpart F Regime.

Punishment for their past: The S. 965 Transition Tax imposed a retroactive tax on earnings which (1) were not previously subject to US taxation and (2) were never distributed to shareholders. In simple terms, S. 965 imposed real taxation on past income that had never been received by shareholders.

Hindering their future: The S. 951A GILTI rules were designed to prevent the future use of small business corporations to defer income.

The effect of these two provisions was and continues to be devastating for dual U.S. Canada citizens living in Canada (and other countries). The transition tax confiscated a significant part of their retirement savings. The GILTI provisions dramatically increased the difficulty of individuals making use of existing and well understood retirement planning opportunities available to other Canadians.

(In fact, the Transition Tax was so devastating that it spawned the "Transition Tax" lawsuit organized by Israel based US tax lawyer Monte Silver. https://www.courtlistener.com/recap/gov.uscourts.dcd.203770/gov.uscourts.dcd.203770.29.0.pdf)

At a minimum, it's clear that U.S. International Tax provisions, always discussed in the context of multi-national corporations, have had and continue to have seismic impacts on individual U.S. citizens living outside the United States. The hearing included a **discussion of both raising the US corporate tax rate (28%) and doubling the GILTI tax.**

Either of these proposals would - for different reasons - be very damaging to individual Americans abroad. The increase in the US corporate rate to 28% would mean that the "high tax GILTI kickout" rate would increase from 18.9% to 25.2%. In other words, raising the corporate rate would mean that income currently excluded from the definition of GILTI income, would now be included as GILTI income. It is likely that doubling the tax rate on GILTI income would result from doubling the amount of income subject to the GILTI tax. Each of these proposals will independently have a very bad tax and compliance result for Americans abroad. Tragically this was NOT considered as part of the discussion in the hearing.

The bottom line is: any discussion of tax reform for corporations will affect Americans abroad**. Think of it this way: every individual American abroad is treated as though he/she were a mini-multinational.**

Congressional Indifference To How Corporate Tax Provisions Impact Individuals

The U.S. tax code, coupled with the indifference of Congress and Treasury to Americans abroad, has created a regime where every U.S. citizen living outside the

United States is treated as though he/she were a "mini multinational." Surely, these consequences could not have been intentional.

The Taxation Of Americans Abroad in General

Americans abroad are subject to the third pillar of U.S. taxation – The Extraterritorial Tax Regime. Because their income and assets are foreign to the United States (although local to them) they are subject to more punitive taxation than are their friends and family who are U.S. residents. As counter-intuitive as it may be, when U.S. citizens live outside the United States, they are subject to the extraterritorial tax regime – a regime that is more punitive than the ("residence" system applied to U.S. Residents). This results from a combination of (1) their assets and income being foreign to the United States coupled with (2) the fact that they are also tax residents of other countries.

Furthermore, Americans abroad are increasingly subject to real taxation on deemed income that they have never received. Examples include: transition tax, GILTI, Subpart F generally, fake income created by exchange rate fluctuations and U.S. taxation of income that is not taxable in their country of residence (such as the sale of a principal residence). The complexity, cost and unfairness has led to a situation where more and more Americans abroad are being forced to renounce their U.S. citizenship in order to survive. To be clear, Americans abroad are NOT renouncing U.S. citizenship because they want to. They are renouncing U.S. citizenship because they have to.

The History of Tax Reform and Americans Abroad

FATCA became law on March 18, 2010. A primary effect of FATCA was to increase awareness of the U.S. extraterritorial tax regime. Specifically, the imposition of U.S. worldwide taxation on the non-U.S. income of individuals who are tax residents of other countries and do not live in the United States. As a result, Americans abroad have worked very hard to have a voice in tax reform. To date Americans abroad have been completely ignored. The time has come for Congress to end the extraterritorial tax regime (employed only by America) and transition to a system of taxation based on only "residency" and "source" (employed by the rest of the world). This is commonly called transitioning to a system of "residency-based taxation".

Over the decade since FATCA was enacted, Americans abroad have repeatedly pleaded with Congress to fix the extraterritorial aspects of the U.S. tax system. These pleas have included:

2013 – House Ways And Means Committee On Tax Reform

Americans abroad made at least 224 submissions to the House Ways and Means Committee about tax reform:

https://www.box.com/v/citizenshiptaxation/folder/3414062298

2015: Senate Finance Committee

Americans abroad made at least 267 Submissions to the International Tax Committee to the Senate Finance Committee

https://www.box.com/v/citizenshiptaxation/folder/3414083388

The 2015 Senate Finance Committee Report did NOT address the concerns of Americans abroad. The lobbying of Americans abroad was recognized on page 80 in (literally) the very last paragraph of the report.

> *"F. Overseas Americans*
>
> *According to working group submissions, there are currently 7.6 million American citizens living outside of the United States. Of the 347 submissions made to the international working group, nearly three-quarters dealt with the international taxation of individuals, mainly focusing on citizenship-based taxation, the Foreign Account Tax Compliance Act (FATCA), and the Report of Foreign Bank and Financial Accounts (FBAR).*
>
> *While the co-chairs were not able to produce a comprehensive plan to overhaul the taxation of individual Americans living overseas within the time-constraints placed on the working group, the co-chairs urge the Chairman and Ranking Member to carefully consider the concerns articulated in the submissions moving forward."*

https://www.finance.senate.gov/imo/media/doc/The%20International%20Tax%20Bipartisan%20Tax%20Working%20Group%20Report.pdf

2017 – Tax Cuts And Jobs Act

Residence-based taxation for Americans abroad was reported to have been considered by Chairman Brady in the days leading up to the TCJA. As reported by the Financial Times on October 25, 2017.

https://www.ft.com/content/4909d804-b9a1-11e7-8c12-5661783e5589

Unfortunately, residence-based taxation did not come to pass in 2017. In fact, Americans abroad were subjected to the Transition Tax and GILTI making a bad situation far worse. The necessity of transitioning to residence-based taxation was acknowledged by Representative George Holding after the 2017 TCJA was signed into law:

> REPRESENTATIVE GEORGE HOLDING: ***As companies begin to see the benefits of this new territorial system, I look forward to continue to work with the Chairman to explore ways to move towards a residency-based taxation system to ensure that American citizens have a level playing field around the globe as well.
>
> *** CHAIRMAN KEVIN BRADY: Mr. Holding, I want to thank you for your leadership on this issue. In particular, about international competitiveness

> for our workers. So, residence based taxation is an idea we should continue to explore. We'll continue to work on this issue with you as leadership, and with that I yield back.

https://www.c-span.org/video/?c4692161/user-clip-congressman-holdings-comment-rbt

2018 – Representative Holding's Tax Fairness For Americans Abroad Act

As described by "American Citizens Abroad":

> **Congressman Holding Introduces "Tax Fairness For Americans Abroad Act of 2018 (H.R. 7358)" – A Residency-Based Taxation Bill**
>
> On December 20, 2018 Congressman Holding (Republican-North Carolina), a member of the influential House Ways & Means Committee, introduced a tax bill that is a critical first step toward transitioning from the current citizenship-based taxation system to a system that provides residence-based taxation for individuals – sometimes referred to as territorial tax for individuals. By taking this first step toward ending the onerous burdens of citizenship-based taxation, Americans will become more competitive in the international job market and free to pursue opportunities around the world. Compliancy costs and the burden of exposure to double taxation will be significantly reduced, and tax fairness will be restored for US citizens living and working overseas

https://www.americansabroad.org/tax-fairness-act-rbt/

2021 – Congress Is Again Considering Tax Reform

Clearly the March 25, 2021 hearings were part of a larger and continuing discussion of the reform and evolution of the US system of International Tax. The International Tax System includes the taxation of individuals generally and of Americans abroad specifically.

It is imperative that attention be given to the plight of Americans abroad. Renunciations of U.S. citizenship are rising. Americans are NOT renouncing U.S. citizenship because they want to. They are renouncing U.S. citizenship because they are forced to choose between compliance with U.S. tax laws and being able to engage in responsible and necessary financial planning for themselves and their families. It is time for Congress to lead and correct this injustice.

SEAT joins other groups in requesting that Congress end the extraterritorial tax regime (citizenship-based taxation) and join the international standard of residence-based taxation.

A request to participate in the ongoing hearings

U.S. international tax rules continue to have a huge impact on the lives of INDIVIDUAL U.S. citizens who live in the United States and abroad. A consideration of how US tax rules apply to individuals generally and to Americans abroad in particular is long overdue.

Americans abroad can be valuable as witnesses in further hearings. Although the views of academics and tax policy analysts have value, they do not live the day-to-day application of these rules. It's time for Americans abroad to be directly included in the discussion.

Respectfully submitted by …

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