Re: “Creating Opportunity Through A Fairer Tax System”

Hearing April 27, 2021

Submission on behalf of Stop Extraterritorial American Taxation (SEAT)

Address:
3 impasse Beauséjour
78600 Le Mesnil le Roi
France
info@seatnow.org

Email to: Statementsfortherecord@finance.senate.gov
Senate Committee on Finance

7 May 2021

Please accept this as our submission with respect to the subject of the April 27, 2021 Senate Finance Committee Hearing: “Creating Opportunity Through A Fairer Tax System.”

Previous hearings have focused on large corporations and high net worth individuals. The hearing on April 27, 2021 focused on a wealth tax. No hearing has recognized the impact of the proposals on US citizens living outside the United States who are tax residents of countries outside the United States. It is important for Congress to understand that any change in the US tax system that does not remove the current citizenship-based extraterritorial tax regime will exacerbate the problems facing US emigrants and the small businesses they run in their countries of residence. In this hearing, the problems created by extraterritorial taxation were not only ignored, but one witness held up the citizenship-based extraterritorial tax regime as the reason why a wealth tax would work for the US when it has failed in so many other countries.

In our submission, we remind the committee of the problems created by the extraterritorial tax system and discuss the implications of using citizenship-based taxation as an enforcement tool for a wealth tax on ordinary Americans living outside of the US.

Part A: Context

The Internal Revenue Code establishes three distinct US tax regimes:

1. **Non-resident Alien Tax Regime:** Taxation on US source income only
2. **Tax Regime For US Residents:** Taxation of US residents on worldwide income (regardless of citizenship)
3. **Extraterritorial Tax Regime:** Taxation of the worldwide income, mostly non-US source income of individuals who are US citizens, who do not live in the United States and are tax residents of other countries. This is a separate and more punitive tax regime[1] than that imposed on US citizens living outside the United States. To put it simply: The extraterritorial tax regime is based on citizenship regardless of economic or physical connection to the United States. Some – including the Committee witness Professor Gamage - refer to the extraterritorial tax regime as “citizenship-based taxation”.

[1] https://www.taxconnections.com/taxblog/the-united-states-imposes-a-separate-and-much-more-punitive-tax-on-u-s-citizens-who-are-residents-of-other-countries/

The extraterritorial tax regime applies to the non-US source income of US citizens (and Green Card holders) who live outside the United States and are tax residents of other countries. For example a US citizen Yoga teacher living in France who is paid in France is subject to US taxation on that French income. The extraterritorial tax regime is a more punitive and more penalty-laden regime than the tax regime imposed on US residents. This is the direct result of the income and assets of Americans abroad being (although local to the individual), foreign to the United States.

Indeed, the Senate Finance Committee recognized the problem of the extraterritorial tax regime, at least as early as 2015. That is when the Senate Finance Committee Bipartisan Tax Working Group[2] on International Tax concluded their report[3] with the following paragraphs:

> *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).*
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> *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.*

In other words, in 2015 the Senate Finance Committee recommended that that the negative effects of the extraterritorial tax regime be specifically considered.

Six years have passed and there is still no movement on overhauling the taxation of individual US citizens living overseas, in spite of the clear directive from the International Tax Working Group. In fact, the situation for US citizens abroad has gotten far worse. This is due in large part to the enhancements to the Subpart F regime in TCJA.[4] We informed the Senate Finance Committee in that regard in our submission dated April 22, 2021, available here.[5]

The Senate Finance Committee Must Consider Its Laws from The Perspective of Both:

A. The tax regime imposed on US residents; and
B. The extraterritorial tax regime imposed on US citizens living outside the United States.

SEAT is unaware of a single instance in which the Senate Finance Committee has considered how proposed legislation affects US citizens abroad - who are subject to the US extraterritorial tax regime.

SEAT respectfully submits that because the United States is operating an extraterritorial tax regime which applies uniquely to US citizens abroad, the Senate Finance Committee has an obligation to follow the 2015 directive of the Senate Finance Committee and consider the impact of tax changes on US citizens abroad, who are by definition subject to the extraterritorial tax regime.

The Scope of The 2021 Senate Finance Committee Hearings – No Consideration Of Individuals

Since March 2021 the Senate Finance Committee has been considering changes to the workings of the US tax system. For the most part the hearings have discussed tax changes to US corporations. Neither the Committee itself, nor a single witness has mentioned or considered the profound implications of the proposed changes to corporate taxation, on the millions of individual US citizens living in the United

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2 https://www.finance.senate.gov/chairmans-news/finance-committee-bipartisan-tax-working-group-reports
3 http://www.finance.senate.gov/download/?id=E1FA3F08-B00C-4AA8-BFC9-7901BD68A30D
4 *An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018*, Pub Law 115-97. Known colloquially as *The Tax Cuts and Jobs Act* (TCJA).
5 http://seatnow.org/wp-content/uploads/2021/04/SEAT-Submission-Overhauling-International-Taxation.pdf

States or living abroad. **Yet, as we have described in previous submissions, the proposed changes to corporate tax will impact far more individual US citizens abroad than US multinationals.** This follows from the fact that when a US citizen runs a small business using the business structures common in their non-US country of residence they are often treated as a *US Shareholder* of a *Foreign Corporation*, and are therefore subject to the same Subpart F rules that apply to multinational corporations headquartered in the US.

Part B: Implications of a Wealth Tax for US citizens living abroad

The title to this hearing bears little relation to what the hearing was actually about. The hearing was for the purpose of introducing Senator Warren's proposed wealth tax. Hence, our remarks in this submission, will be restricted to the question of a Wealth Tax and its implications for the millions of individual US citizens living abroad, who are subject to the extraterritorial (citizenship) tax regime.

About the Wealth Tax In General - Senator Warren In Her Own Words: Excerpts from a recent CNBC interview …[6]

> *WARREN: Based on fact, the wealthiest in this country are paying less in taxes than everyone else. Asking them to step up and pay a little more and you're telling me that they would forfeit their American citizenship, or they had to do that and I'm just calling her bluff on that. I'm sorry that's not going to happen.*
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> *WARREN: Look, they want to use American workers. They want to use American highways. They want to use American police forces. They want to use American infrastructure, but they just don't want to help pay to support it. And that's the trick, a wealth tax needs to be national because you can still get advantages, if you move from state to state.* ***But the idea behind wealth tax is you have to pay it if you're an American citizen. It doesn't matter whether you live in Texas or California or even whether you move to Europe or South America. If you want to keep your American citizenship, you pay the wealth tax and it doesn't matter where you put your assets.*** *You can try to hide them in the Cayman Islands, you can try to put them up in Switzerland, but it doesn't matter, you still pay the two-cent wealth tax. And here's the nice thing about that, you know, a lot of the wealth is quite visible and easy to see, it's right there in the stock market. A two-cent wealth tax changes this country fundamentally because it means we say as a nation, we are going to invest in the next generation. We're going to invest in creating opportunity not just for a handful at the top, we're going to create opportunity for all of our kids. That's how we build a strong future in this country.*

Senator Warren's own words confirm that the effectiveness of her proposed wealth tax is dependent on the application of the US extraterritorial (citizenship-based) tax regime which is imposed on US citizens abroad.

SEAT would like to raise three issues about this proposed wealth tax: first the measurement of the dollar threshold over which the tax applies, second, how the tax base is computed, and third, the potential impact of the proposed enforcement methods.

Wealth Tax Threshold

On or about March 1, 2021, Senator Warren introduced her proposed "ULTRA-Millionaire Tax Act Of 2021". The threshold for the tax is $50 million USD. There is nothing in the proposed act that suggests this threshold is indexed to inflation. Even if the threshold is NOT lowered (which it will

[6] https://www.cnbc.com/2021/01/28/first-on-cnbc-cnbc-transcript-senator-elizabeth-warren-d-mass-speaks-with-cnbcs-closing-bell-today.html

most certainly be), the inevitability of inflation will ensure that more and more people are ensnared by it. In the same way that the late Senator Kennedy referred to the 877A Exit Tax[7] as the billionaire's tax[8] (when it applied to everyday people), *over time, the wealth tax will become the millionaires' tax that will be applied to (by the standards of today) thousandaires.*

Furthermore, the threshold is measured in US Dollars. This is fair enough for individuals whose wealth and income are tied to the US economy. However, for US citizens whose economic life is exercised entirely outside of the US, the requirement that all US tax computations be made *as if* they ran their lives and businesses in US Dollars creates currency risk for individuals whose financial life actually runs in a single currency.

What is included in the tax base?

Senator Warren's wealth tax would apply to the non-US assets (among other things) of US citizens living in other countries. US citizens include: 1. American Expatriates (living abroad temporarily) 2. American Emigrants (living permanently outside the United States) 3. Accidental Americans (possibly never having lived in the United States). This would include assets that are part of the economies of other sovereign nations and that were accumulated *after* the individual emigrated from the US; that is, the tax base includes assets that have no economic connection to the United States.

Furthermore, it is drafted in a way that the assets of the non-US citizen spouse may be part of the calculation!

Therefore: To Impose The Wealth Tax On US Citizens Abroad Is To Impose The Wealth Tax On (1) Tax Residents On Other Countries and (2) On Assets In Other Countries Which May Not Necessarily Be Owned by US Citizens.

As explained by US tax lawyer Virginia La Torre Jeker,[9] the proposed wealth tax applies to anybody in the world. Nonresidents (however they may be defined) would be assessed a wealth tax based only on their US assets. A podcast with Virginia La Torre Jeker about the impact of the wealth tax on US citizens living abroad is available at this link.[10]

Using the Extraterritorial Tax Regime as an Enforcement Tool for a Wealth Tax

Professor David Gamage confirms that the extraterritorial tax regime, *which the 2015 Senate Finance Committee recommended should be reconsidered*, is the tool used to enforce the proposed wealth tax!

What follows is a transcript of part of Professor Gamage's testimony at the April 27, 2021 hearing:

> *1:15:10 – Second exchange between Senator Cassidy and David Gamage*
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> *Cassidy: Do you favor a worldwide wealth tax because that doesn't seem practical to me but that seems like people can move and they do. And capital can move and it does. One example for example: I understand that China has an incredible capital flight and if there's any country that's*

[7] http://citizenshipsolutions.ca/2018/11/14/considering-renouncing-us-citizenship-thinking-citizide-abandoning-your-greencard-expatriationlaw-webinar-explaining-the-s-877a-exit-tax/
[8] http://citizenshipsolutions.ca/2015/04/05/part-5-the-exit-tax-in-action-five-actual-scenarios-with-5-actual-completed-u-s-tax-returns/
[9] https://us-tax.org/2021/03/11/what-does-senator-warrens-proposed-wealth-tax-mean-for-you/
[10] https://prep.podbean.com/e/the-impact-of-the-proposed-warren-wealth-tax-on-americans-abroad/

done its best to surveille everything about every one of its citizens it's China and yet they have significant capital flight. So, would you recommend a global wealth tax?

Gamage: The United States tax system – the current income tax is citizenship-based and taxes all worldwide income for citizens and always has. This is a key difference between the US tax system and the French tax system. You can't escape the US taxation without revoking your citizenship and paying a substantial exit tax. That's current law and it works quite well.

Cassidy: And so the idea that somebody would give up their citizenship – I think one of the partners that made a lot of money from selling – some big Silicon Valley going public, renounced his citizenship and moved to Singapore, if I remember correctly. I'm gathering from you you feel as if that problem would be minimal.

Gamage: It historically has been minimal and you pay a big exit tax…

Cassidy: Historically we haven't had a wealth tax so I'm not sure we can use past history to predict future actions to kind of paraphrase the financial commercial.

Gamage: Again, you pay a substantial exit tax under current law by revoking citizenship. Not many people do it. Some do. If they don't value the protections and services provided to citizens of the United States then fine. But the protections and services provided to extreme wealth are huge and most ultra-wealthy benefit tremendously from being United States citizens and having those protections and services, and it's fair to have them pay a reasonable amount of tax on that which they currently are not.

It's not clear what part(s) of the current extraterritorial tax system Professor Gamage thinks work "quite well", but from the perspective of Americans actually living outside of the US, the system is inherently dysfunctional. Numerous surveys[11] have been conducted which provide ample evidence that the US tax laws (including the FATCA enforcement system) have resulted in handicapping Americans abroad whose financial lives are necessarily foreign to the US. These Americans have difficulty keeping bank accounts, saving for retirement, and running small businesses. Furthermore, while high net worth individuals might pay a substantial exit tax to renounce their US citizenship, the threshold for this tax has been set at such a low level that middle-class Americans with retirement savings are often subject to this tax that was initially aimed at billionaires.

Part C: The Senate Finance Committee Continues A Long History of Misunderstanding And Prejudice Toward US Citizens Abroad

Former Senator Max Baucus – one of Senator Wyden's predecessors as Chair of the Senate Finance Committee – was not immune to this prejudice. In 1995, he stated:

> *[Americans] are going to great lengths, thousands of miles to other countries, to avoid paying their fair share. In a metaphorical sense, burning the flag, giving up what should be their most sacred possession, their American citizenship, to find a tax loophole. . . . These are precisely the sort of greedy, unpatriotic people that FDR called malefactors of great wealth. . . . Let us not allow more of these rich freeloaders to get away.*[12]

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[11] See, for example, "Survey Report: "Being an American Outside of America is No Longer Safe." (2021) at http://seatnow.org/survey_report_intro_page/; "I Feel Threatened by My Very Identity: US Taxation and FATCA Survey" (2019) at http://citizenshipsolutions.ca/2019/10/27/recently-released-survey-report-dispels-myth-of-the-wealthy-american-abroad-and-demonstrates-why-middle-class-americans-abroad-are-forced-to-renounce-us-citizenship/ .

[12] 3 S. COMM. ON FIN., TAX TREATMENT OF EXPATRIATED CITIZENS: HEARING ON S. 453, S. 700, H.R. 831, H.R. 981, H.R. 1535 & H.R. 1812, 104th Cong. 2 (July 11, 1995),

This profoundly ignorant comment from Senator Baucus, alongside many others expressed by other members of the United States Congress dating back to the Civil War right up to today,[13] expose longstanding and deep-seated prejudices against Americans who live outside the United States. Is it any wonder that these prejudices have been translated into extraterritorial taxation and banking policies that are highly damaging to Americans and green card holders living outside the United States? It appears that Senator Warren's wealth tax is premised on many of the same profoundly ignorant assumptions about US citizens living outside the United States.

Part D: The Solution: Ending the US Extraterritorial AKA Citizenship-Based Tax Regime

The best solution to this problem is for the United States to come into alignment with every other developed nation on the planet and **move to a residence-based taxation system for individuals**. Taxing non-resident citizens is "Mission Impossible," as it is impossible to fairly administer an extraterritorial tax system and afford non-resident US citizens the rights guaranteed by the Taxpayer Bill of Rights (IRC §7803(a)(3)), by multiple human rights instruments and by the US Constitution.[14]

It is well past the time that the Senate Finance Committee act upon the call of the 2015 Senate Finance Committee Bipartisan Tax Working Group on International Tax, and finally accord to Americans living outside the United States the full attention, concern, and respect to which they are entitled as US citizens. It is also well past time to put an end to the taxation and banking policies that penalize them so severely.

Thank you for your attention to these matters.

Respectfully submitted by:

Stop Extraterritorial American Taxation (SEAT) Board Members (info@seatnow.org):

Dr Laura Snyder (President)
Dr Karen Alpert
Suzanne Herman
David Johnstone
Keith Redmond
John Richardson

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.

http://www.seatnow.org

https://www.finance.senate.gov/imo/media/doc/Hrg104-795.pdf [https://perma.cc/7LDH-XW26] (statement of Sen. Max Baucus). See also https://www.c-span.org/video/?66084-1/tax-treatment-expatriates

[13] Laura Snyder, "Taxing the American Emigrant," 74(2) Tax Lawyer 299 (2021)., Available at SSRN: https://ssrn.com/abstract=3795480 , at 317-20.

[14] Laura Snyder, Karen Alpert, and John Richardson, *Mission Impossible: Extraterritorial Taxation and the IRS*, 170 Tax Notes Federal 1827 (March 22, 2021), Available at SSRN: https://ssrn.com/abstract=3828673.