Re: “The IRS, the President's Fiscal Year 2023 Budget, and the 2022 Filing Season”

Hearing April 7, 2022

Submission on behalf of Stop Extraterritorial American Taxation (SEAT)

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Senate Committee on Finance

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Please accept this as our submission with respect to the subject of the April 7, 2022 Senate Finance Committee Hearing: “The IRS, the President's Fiscal Year 2023 Budget, and the 2022 Filing Season.”

The United States is the only developed nation to impose its tax code on all citizens, regardless of where they live, using the same rules for both domestic and international taxpayers. Most other countries assert the right to tax the worldwide income of residents, but not of non-resident citizens. The US taxes the worldwide income of *both* residents (regardless of citizenship) *and* non-resident citizens. Because the Internal Revenue Code has many special and punitive rules for “foreign” income, assets, and investments, this means that US tax rules have a significant impact on the ability of Americans overseas to plan for retirement, invest, run small businesses, and have bank accounts in the countries where they live. While SEAT strongly advocates for a move to taxation based on ***residence*** rather than citizenship (as widely practiced in the rest of the world), if citizenship-based taxation is to continue, it is incumbent on Congress to carefully consider the impact of new legislation on this subset of American citizens.

The Biden Green Book for fiscal year 2023, released on March 28, 2022, contains a number of proposals to both increase tax rates and increase the tax base by increasing the number of activities that are taxable events. Generally, the proposals include a number of provisions to create and enhance taxation on both income from capital and capital itself. Significantly the Green Book does not suggest a move away from US citizenship taxation toward resident taxation as embraced by the rest of the world. In their totality, the proposals (particularly those that create income realization events when a gift is made) suggest a worsening of the situation for Americans abroad. That said, one proposal “might” (depending on Treasury) allow for the relaxation for the 877A Exit Tax rules, for a narrow group of Americans abroad under certain circumstances.

We would like to highlight six proposals in the Green Book that could have a disproportionate effect on Americans abroad:

1. Raising The Corporate Tax Rate To 28 percent – Creating Subpart F Income and Making More Americans Abroad GILTI – Page 2
2. Reducing Phantom Gains and Losses: Simplify Foreign Exchange Rate and Loss Rules for Individuals and Exchange Rate Rules for Individuals – Page 90
3. Strengthening FATCA: Provide for Information Reporting by Certain Financial Institutions and Digital Asset Brokers for the Exchange Of information – Page 97
4. Expatriation – The Stick: Extend the Statute of Limitations for Auditing Expatriates to Three Years from The Date from Which 8854 Should Have Been Filed (Possibly Forever) – Page 87
5. Expatriation – The Carrot: Exempting Certain Dual Citizen Expatriates from The Exit Tax – Page 87
6. Reform the Taxation of Capital Income – Page 30

1. Raising the Corporate Tax Rate to 28%

The Internal Revenue Code is a complex machine with many interdependent moving parts. Even a change as conceptually simple as raising the corporate tax rate can cause unforeseen problems due to interactions within the tax code. Raising the corporate tax rate will adversely affect Americans abroad with corporations. Unlike Americans living inside the US, when Americans abroad own a small business corporation, that corporation is likely to be "foreign" and therefore considered a Controlled Foreign Corporation (CFC) under rules found in 951 to 965 of the Internal Revenue Code. Increasing the US corporate tax rate will affect the ability of American entrepreneurs abroad to avoid double taxation through exclusions to both Subpart F income and GILTI based on the ratio of the effective corporate tax rate paid where they live and the US corporate tax rate. Furthermore, as noted in the Green Book, increasing the corporate tax rate has the effect of increasing GILTI. GILTI and the CFC rules, applied to small businesses run by individual Americans abroad, constitute an additional cost that their local competitors do not bear and therefore erode the competitive position of these entrepreneurs solely because they are American citizens.

2. Reducing Phantom Gains and Losses

All American citizens are tethered to the US dollar as their functional currency. Yet they live their lives in the currency of the country where they reside. Every taxable transaction that takes place in that foreign currency must be converted to the US dollar to determine its US tax impact. Many Americans abroad have experienced the pain of having to pay tax on phantom capital gains. Where an American abroad has a mortgage on their principal residence, these rules operate separately on the mortgage and the value of the home, guaranteeing that there will be a currency gain on one leg of the position and a loss on the other. However, to add insult to injury, with respect to personal use real estate, the gains are taxable, but the losses are not deductible. This peculiar form of the American nightmare is found in Internal Revenue Code 988. The proposal to allow currency losses on a mortgage to the extent of gain realized on the home solves half of this problem. The other side of the transaction should be recognized as well by exempting currency gains on the mortgage to the extent of losses on the home.

3. Strengthening FATCA

The Green Book recognizes:

1. The importance of information exchange; and
2. The fact that the US is not meeting its exchange obligations under the FATCA IGAs.

This proposal is an attempt to strengthen FATCA (which is why it is of interest to individuals) by requiring the US to meet its obligations under the FATCA IGAs. The current lack of reciprocity has made the US one of the biggest tax havens for non-Americans. But FATCA has an ugly side as well. Across Europe it has caused financial institutions to deny or limit bank accounts to US citizens residing abroad. As regularly suggested by the Taxpayer Advocate, Treasury should use the discretion granted by Congress to exempt from FATCA reporting (by both FFIs and individuals) accounts held by individuals resident in the country or economic zone where the account is located. Americans abroad are not evading US taxes by having their wages deposited in a bank account where they live.

4. Expatriation: Extend the Statute of Limitations for Auditing form 8854

Apparently, there are "expatriates" who fail to file Form 8854. This change would allow for IRS audits of expatriates who fail to file Form 8854 for up to three years from the date Form 8854 is filed, thus leaving the statute of limitations open if the form is not filed. It would be interesting to know whether this proposal is intended to be retrospective. This change would definitely encourage more people to avail themselves of the provisions in the 2019 "Relief Procedures For Former Citizens".

5. Expatriation: Exempting Certain Dual Citizen Expatriates from the Exit Tax

"Expatriation" is defined as either "relinquishing US citizenship" or "Ceasing to be a Permanent Resident". The Internal Revenue Code defines the tax consequences of "expatriation" in 877A (which for the definitions of "covered expatriate" and "long term resident" reference 877(a)(2) and 877(e)(2) respectively). The 877A Exit Tax rules are harsh and extremely punitive as applied to US citizens living outside the United States who have little connection to the United States.

Actually, the idea of the United States imposing worldwide taxation on individuals with no residential connection to the United States is absurd. Many of them don't know they are considered to be US citizens. Others learn they are US citizens because they are identified by a bank pursuant to the FATCA IGAs. A significant percentage don't speak English. It is entirely reasonable that these individuals should NOT be subjected to any aspect of US worldwide taxation, including the 877A Exit Tax. Furthermore, the Green Book frankly admits that there is significant noncompliance with filing Form 8854. Therefore, in a remarkable and unusual instance of common sense, the Green Book proposes an exemption from the Exit Tax rules for certain "dual citizens" (whether dual citizens at birth or not) …

Query: Is this an admission from the Biden administration that for the purposes of US taxation there really is a difference between US citizens who live within the United States and those who live without the United States? Could this possibly be treated as a "crack in the wall" – of that most American tradition – the notion that it should impose worldwide taxation on individuals with no residential connection to the United States?

Conclusion: This proposal would appear to grant Treasury the authority (whether by formal regulation or informal notice) to exempt certain dual citizens from the 877A Exit Tax rules. In other words, they can renounce and simply be done with the USA once and for all. This proposal is clearly in the interest of the United States of America (it is generating a lot of bad will over this issue), the IRS (clearly the biggest victim of US citizenship-based taxation) and the individuals impacted (who are being taxed on non-US income while they are tax residents of another country). What's not to like?

The real problem is the continued existence of US citizenship-based taxation. The time has come to "Stop Extraterritorial American Taxation".

That said, this proposal would provide relief for the individuals who are most unjustly treated under an extremely unjust tax system. If adopted, this would become one more example of what SEAT members John Richardson, Dr. Karen Alpert, and Dr. Laura Snyder have previously proposed as "A Simple Regulatory Fix For Citizenship-based Taxation".

6. Reform the Taxation of Capital Income

One of the proposals here is to treat transfers of appreciated property by gift or on death as realization events for the purpose of taxing the capital gain.

For Americans abroad the impact of treating gifts as income realization events is (at least) two-fold:

First, Americans abroad may be subject to a US income recognition event where there may be no corresponding income recognition event in the country where they reside. This is because the United States might be imposing tax where there was no actual income realization. The country of residence may impose taxation only where there is the realization of income. To the extent that this creates a US tax event without a corresponding realization event in the other country, the proposed taxation on gifts would be similar to the effect of the Subpart F, GILTI, Transition Tax and 877A Exit Tax rules. All of these are examples where there is a US income realization event with no corresponding taxable event in the country of residence.

Second, the Green Book proposes an exemption for gifts made to US citizen spouses but NOT to spouses who are not US citizens! This continues the US tradition of imposing punitive tax consequences on those US citizens who marry non-citizens.

Finally, as goes the complexity of US taxation so goes the difficulty of continuing the US extraterritorial tax regime! The proposed treatment of gifts as income realization events would be one more step in a process of making it impossible for Americans abroad to survive under both the tax system of their country of residence and the US tax system.

It is time for the United States to abolish citizenship taxation – the imposition of US worldwide taxaton on people who live in and are tax residents of other countries. Instead, the US should join the world in adopting residence taxation.

Thank you for your attention to these matters.

Respectfully submitted by:

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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.

http://www.seatnow.org