



# DEMOCRATS ABROAD

## 2017 NON-RESIDENT TAXATION RESEARCH PROJECT

### Can We Please Stop Paying Twice?

Reforming the U.S. Tax Code for Americans Abroad

October 2017

*I have not been "taxable" in the US for many years, but continue to have to have a professional tax preparer do my tax form. This year for the first time, I could probably do it because I'm retired and it's simple, but I'm afraid of making mistakes so I go to the professional yet again. And all that for zero tax liability, on the part of a very law-abiding person! - Connecticut voter living in Belgium who participated in the Democrats Abroad 2017 Non-Resident Taxation Survey*

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<b>TABLE OF CONTENTS</b>	<b>PAGE</b>
Executive Summary	3
Introduction	5
Background	6
2017 Non-Resident Taxation Research Project	8
Overall Concerns of Non-Resident Tax Filers	8
Profiling Americans Abroad	11
Tax Issues Impacting Americans Abroad	13
Addressing Issues Impacting Americans Abroad	17
Implementing Residency-Based Taxation	17
Appendices	
Appendix I – Remedies for Tax Code Provisions That Discriminate Against Americans Abroad	18
Appendix II – Improving Tax Filing And Reporting For Americans Abroad	19
Appendix III – Regulations Constraining Banking, Investment and Retirement Savings for Americans Abroad	20
Appendix IV – Survey Findings	22
Appendix V – Hearing About Tax Matters Not Raised Herein	28

## EXECUTIVE SUMMARY

In September 2017 Democrats Abroad collected submissions from approximately 4,500 Americans living outside the United States in response to a survey on their experience filing U.S. tax returns and reports from abroad declaring their worldwide income. This research forms part of a focused campaign by Democrats Abroad, in association with other groups representing Americans abroad, to provide evidence to U.S. lawmakers that reforms are required to the treatment of non-resident Americans under the U.S. Tax Code.

The data and testimony provided herein demonstrate the nature and extent of the ways the U.S. tax code discriminates against non-resident filers. The 115<sup>th</sup> Congress is working towards a vote on a comprehensive package of corporate and personal tax reforms, with Congress pushing for it to occur before the end of 2017. These findings may persuade the bill writers to include in that package a switch from the current U.S. system of Citizenship-Based Taxation to a system of Residency-Based Taxation.

Under a system of Residency-Based Taxation, Americans living outside the U.S. would continue to declare income generated in the U.S. but would be exempted from reporting to the Internal Revenue Service (IRS) income earned in their country of residence.

Our research shows that non-resident filers pay twice:

1. Initially, this group reports their worldwide income and pays taxes to their country of residence in order to meet their host country's tax obligations.
2. Afterwards - due to the enormous complexity of Internal Revenue Code forms for reporting income generated outside the U.S. - nearly 60% of these non-resident filers pay tax return preparers to complete their U.S. reports and returns.

The irony is that *these filers are usually paying to show that there's no tax to pay*. In the balance of cases where there is a U.S. tax liability, those impacted are paying twice on the same dollar of income. **Americans abroad would like to stop paying twice.**

The adoption of Residency-Based Taxation, supported by 84% of survey participants, would recognize the legitimate participation in, and financial support of, non-resident U.S. citizens in the economies where they live and work, while not impacting the taxation of their U.S.-sourced income which they would continue to report.

When asked about their concerns about filing taxes from abroad, just under 80% of respondents noted *Complexity of Filing*. Two-thirds noted *Stress of Filing* and 63% noted *Cost of Filing*. IRS Forms for declaring income earned abroad are complicated and time-consuming to prepare because a great deal more information is sought from filers about the source of income. Almost a third decried the inaccessible or unhelpful support of the IRS. Although a scant 3% claimed they had *No Concerns*, 67% lamented that they had to file returns at all. On the basis of these responses it is no wonder that 59% of non-resident filers engage tax return preparers to produce their filings; 57% of them pay \$500 or more for the services.

Demographic data provided by survey participants indicates they are ordinary middle class Americans.

- 68% are married
- 59% have an income of \$20-99,000
- 70% are employed or self-employed, working part time or full time
- 90% have earned a bachelor or higher degree
- 59% are female
- 25% are age 65 or over
- 69% have lived abroad for at least 10 years
- 66% have no plans to return to the US to live

Given that 69% of respondents have lived abroad for at least 10 years and that 66% have no plans to return to the U.S. to live, it is not surprising that the tax issue noted most frequently relates to the taxation of long term savings and retirement plans (48% of respondents).

*Reduced Access to Financial Products and Services* was the second most noted issue - an outcome of FATCA and new efforts to enforce the Bank Secrecy Act, USA PATRIOT Act and certain Securities & Exchange Commission regulations.

*Capital Gains Tax Treatment of Non-US Property Sales and PFIC (Passive Foreign Investment Company) Rules on Non-US Investment Funds* were other problems noted by a large proportion of respondents.

Together this data, along with the thousands of comments provided by survey participants, underscore the problems of double or punitive taxation by the U.S. tax code and the difficulties faced by non-resident Americans trying to save for their future. There is, however, a laundry list of problems faced by Americans abroad trying to comply with U.S. tax obligations which were established without due consideration of how they would impact non-residents.

Rather than asking lawmakers and regulators to wrestle separately with the range of deep complexities that arise when an individual is subjected to taxation by two countries, most all issues can be solved at once by reforming the Internal Revenue Code to exempt the reporting of non-US income of Americans resident abroad. 84% of our survey respondents favored a switch from our current system of Citizenship-based Taxation to Residency-Based Taxation. It would relieve them of an obligation that places an enormous financial and emotional burden on them and saddles the IRS with an unenforceable provision that yields little to the U.S. Treasury.

Democrats Abroad restates its published view that any package of tax reforms will only be deemed acceptable if it clarifies and simplifies filing for all Americans, **helps reduce inequality, boost opportunity** and raise revenue predominantly from those with the greatest ability to pay. The advantages of changing from Citizenship Based Taxation to RBT, however, **must primarily benefit ordinary Americans living and working abroad**. And, it **must not open tax avoidance loopholes** or otherwise include avenues for high net worth taxpayers to abuse for the purposes of tax avoidance.

## INTRODUCTION

For the first time since the 1980's, Congress stands a chance of moving a comprehensive package of corporate and personal tax reforms to the floor. Groups representing Americans abroad are responding to this opportunity by pushing to remedy the ways in which the U.S. Internal Revenue Code discriminates against Americans abroad. As part of an on-going campaign to draw Congressional attention to the fear and financial and emotional hardship suffered by Americans abroad and to the urgent need for non-resident taxation reform, Democrats Abroad has prepared research that measures the nature and extent of the problems faced by non-resident tax filers.

Our results indicate that non-resident filers pay twice:

3. Initially, this group reports their worldwide income and pays taxes to their country of residence in order to meet their host country's tax obligations.
4. Afterwards - due to the enormous complexity of Internal Revenue Code forms for reporting income generated outside the U.S. - nearly 60% of these non-resident filers pay tax return preparers to complete their U.S. reports and returns.

The irony is that these filers are usually paying to show that there's no tax to pay.

*Needing to deal with complex tax law while living abroad indefinitely when I ultimately would not owe anything is frustrating, time-consuming, and immensely stressful. It took substantially less time and effort to file three years' worth of taxes in New Zealand as a non-citizen than it did to file a single year of tax information for the United States as a citizen that has not lived in the country for years. - **Minnesota voter living in New Zealand***

In the balance of cases where there is a U.S. tax liability, those impacted are paying twice on the same dollar of income.

*The US taxes my UK teachers' pension which is already taxed here in the UK. The US tax regime taxes my UK ISA (Independent Savings Account) tax-free savings while I cannot access US tax-free mutual funds. - **Connecticut voter living in the UK***

Americans abroad would like to stop paying twice.

Americans abroad would like Congress to reform the U.S. tax code and replace the current system of Citizenship-Based Taxation with a system of Residency-Based Taxation (RBT). Under a system of Residency-Based Taxation, Americans living outside the U.S. would continue to declare income generated in the U.S. but would be exempted from reporting income earned in their country of residence to the Internal Revenue Service (IRS). This, as is often mentioned in discussions of RBT, would put them on a par with the non-resident citizens of all nations except Eritrea. More importantly, it would relieve them of an obligation that places an enormous financial and emotional burden on them and saddles the IRS with an unenforceable provision that yields little to the U.S. Treasury.

This paper outlines the experience of Americans abroad going to great cost and trouble to comply with their tax filing obligations but struggling with rules and requirements that are complex, ill-considered and punitive. Their experience and stories profile the need for urgent relief achievable by including Residency-Based Taxation in 2017 Tax Reform.

## BACKGROUND

A long-standing system of Citizenship-Based Taxation (CBT) requires U.S. citizens living abroad to file annual U.S. tax returns in addition to meeting tax requirements in their countries of residence. With few and limited exceptions, all other nations apply the alternative system of Residency-Based Taxation (RBT) in which individuals are taxed on the income they earn in their country of residence solely by their country of residence.

Research completed by Democrats Abroad in September 2017 shines a spotlight on the ways that CBT creates unnecessary and unfair costs and hardship on the estimated 6+ million tax-liable Americans living abroad, some of whom have never resided in the U.S.

A number of areas in the Internal Revenue Code were developed without due consideration for the impact on Americans living abroad. The complex tax codes of two separate jurisdictions are only partially, and inadequately, addressed by IRS Section 911 *Foreign Earned Income Exclusion* and various foreign tax treaties. As an American living abroad, being subjected to two competing tax jurisdictions results in double taxation for various types of income. Income types that are double or punitively taxed include, but are not limited to:

- Non-US long term savings
- Non-US retirement savings plans
- Capital gains on non-US property disposals
- Withdrawals from non-US pension plans (even foreign Government pension plans are non-qualified)
- Social welfare payments from foreign governments
- Bequests to foreign surviving spouses

Provisions in separate sections of the tax code give rise to these problems. Addressing them would require reforms in each section and in the model U. S. double taxation treaty and existing bi-lateral tax treaties. (See Appendices I, II and III.)

Groups representing Americans abroad have met with lawmakers and regulators over the years to explain these problems and discuss remedies. Establishing and legislating solutions would require a considerable investment of time and political will for Congress. Addressing the problems that exist in the model U.S. double taxation treaty and the existing bi-lateral treaties alone cannot occur until Senator Rand Paul releases his block on bringing tax treaties up for a vote in the Senate.

**Introducing a straightforward system of Residence-Based Taxation would solve this myriad of taxation complexities and alleviate the costs and fears of Americans living abroad once and for all, with minimal effort required by Congress.**

*I am always afraid of mistakes or errors that will bring fines or charges. The cost of paying for multiple returns is prohibitive and it's difficult finding accountants and lawyers with an understanding of both countries tax laws. Canada is not a tax haven. – Texas voter living in Canada*

The adoption of Residency-Based Taxation, supported by 84% of survey participants, would recognize the legitimate participation in, and financial support of, non-resident U.S. citizens in the economies where they live and work, while not impacting the taxation of their U.S.-sourced income which they would continue to report.

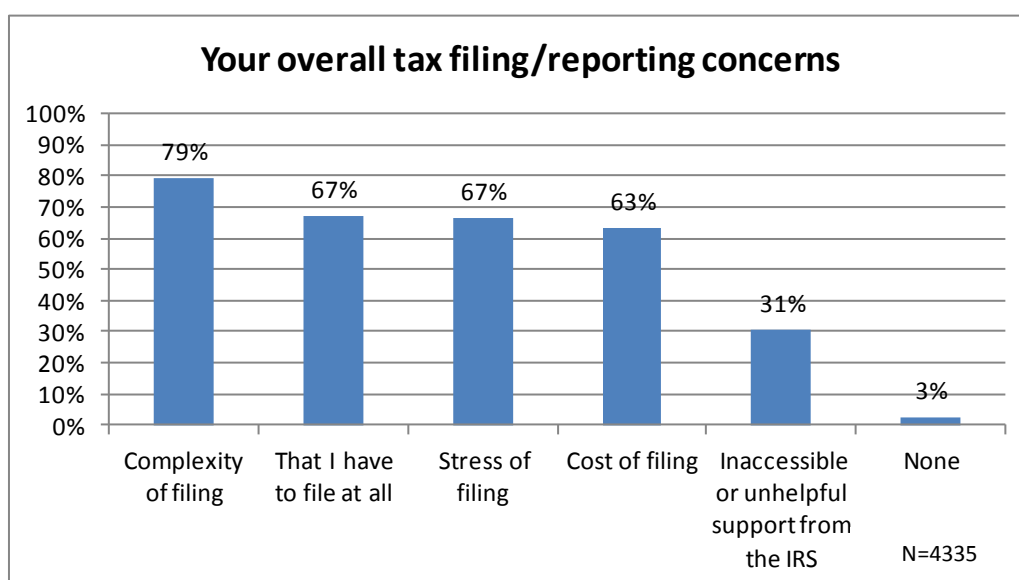
## 2017 NON-RESIDENT TAXATION RESEARCH PROJECT

From September 4 through 24 2017 Americans living abroad were surveyed about their experience reporting their income and financial accounts to the U.S. Internal Revenue Service. Approximately 4,500 submissions were received from Americans living in at least 94 different countries and voting in all 50 states, the District of Columbia and Guam.

Responses demonstrate the broad range of Americans living and working abroad, their overall tax filing and reporting concerns and the tax issues impacting on them. The findings are profiled herein.

### Overall Concerns of Non-Resident Tax Filers

Survey participants were asked about their overall tax filing and reporting concerns as a non-resident American and responded as follows:



*Complexity of Filing* non-US income was the concern noted most frequently (79% of respondents).

*I speak four languages, have a PhD. and am still not intelligent enough to work out the forms properly. - New Hampshire voter living in the Czech Republic*

*I've done taxes professionally and I can deal with it, but filing is insanely complex, with lots of differences between U.S. and Swedish forms and regulations. If or when I die it will be impossible for my wife to deal with the accounting, she'll have to immediately sell all U.S. assets and transfer the proceeds to Sweden, paying a lot of taxes that would otherwise be unnecessary. This duplicate reporting also impacts our kids, and they also would be left in the lurch since they're not used to filing U.S. returns (I do it for them). - Alaska voter living in Sweden*

*Trying to file taxes as a self-employed consultant in a francophone country is a nightmare. It's like comparing apples to oranges... Everything is different - income calculation, revenue, expenses, deductions, taxes, tax rebates, withholding etc.etc. The whole idea of citizen based versus territory based is detrimental to consultants. - Maryland voter living in Gabon*



*Most of the instructions are written in a language that is so impenetrable that it is impossible to file accurate forms without professional assistance, assistance that is often frightfully expensive if it is available at all to overseas filers. - Wisconsin voter living in Germany*

*Filing taxes is really expensive and complex to do from Peru, and I've never had to pay any taxes at all when I've been working and living abroad. For me is an extra expenditure that doesn't go to the state (it goes to a private accountant), and a stress because it means I have to file taxes both where I live and in the states. - New York voter living in Peru*

This response probably goes hand-in-hand with the high response rate for *Stress of Filing*.

*My problem is that it is stressful, confusing, I lack documentation to prove my income (and what documentation I have is in Chinese under my Chinese name, so what use is it anyway to the IRS?) My income is less than \$45,000/year and I have no tax liability. However, the filing process is stressful and confers me no benefit -- I am unable to prove residency in any U.S. state for the purpose of receiving benefits or entitlements, or for the purpose of signing up for health insurance, or even for the purpose of renewing my driver's license. So why should I have to stress over this or pay someone to prepare my return to prove I owe nothing? - Minnesota voter living in China*

*Tax season is complicated enough, but doing it twice, trying to figure out if I've done it all right, knowing that there is a 99.99% chance of me not owing anything is just stressful and again unfair. I already pay HUGE taxes where I live. - South Carolina voter living in France*

*The current filing system makes it impossible for me to file online, since my spouse is not a US Citizen. That means every year tracking down a paper application and filing that way -- even though in the end I usually owe nothing (or am owed something back). It takes a ridiculous [SIC] amount of time for something that in other countries is quite simple and streamlined. - Washington voter living in Portugal*

IRS Forms for declaring income earned abroad are complicated and time-consuming to prepare because a great deal more information is sought from filers about the source of income. It is no wonder, therefore, that 59% of non-resident filers engage tax return preparers to produce their filings and 57% of them pay \$500 or more for the services.

*I have not owed any taxes since moving out of the US, but I have to pay someone to prepare them every year. - California voter living in Guatemala*

*We pay someone to prepare our taxes because the paperwork is so long and complex. While it is money well spent to be sure we have filed properly, it is time and money spent each year to prove we don't owe US taxes. - Texas voter living in India*

*I spend roughly \$1000 each year to have my US based CPA prepare my taxes for IRS and New Jersey. At the end, I do [not] owe or receive any money, but the process is time consuming and complex. - New Jersey voter living in Malaysia*

*I need to hire two tax attorneys now. One in the Dominican Republic and one in the US, along with a separate CPA. Even though I don't usually have to pay any taxes because of the exception, I have to pay thousands of dollars in lawyer fees each year just to be current on my obligations. This creates an extra, unnecessary, heavy burden on my family's financials. - Florida voter living in the Dominican Republic*

*Americans who live, work, and pay taxes abroad every day of the tax year should not have to spend over \$500 dollars to prove that they owe the IRS \$0. The filing process is far too complicated to wade through oneself! - Connecticut voter living in Malta*

*I have to pay 550 dollars a year to have a professional handle my taxes because it ends up being a booklet full of nearly 100 pages of forms. It is impossible for me to figure that out on my own, all because I have investments (stocks, mutual funds) etc. I don't earn a LOT of*

*money and it's absurd I can't file on my own in a more straightforward way. I'm willing to pay taxes, I want to contribute, why make it such a battle? - Texas voter living in Argentina*

*I found out about the filing requirements by reading [about it] in the Globe and Mail. Then I spent \$10k on two cross-border accountants, the first of which had no idea. All of that revealed that I owed \$364 in tax. - New Mexico voter living in Canada*

Almost a third decried the inaccessible or unhelpful support of the IRS.

*The IRS is cumbersome to contact and you get stuck waiting on the phone for around an hour before someone answers. You may be then transferred to another department to again wait. They may or may not be able to give you an answer. They are polite but don't know everything. - Nevada voter living in Switzerland*

*Unless you pay a professional, even if you have a small income, the complexity of filing and the difficulty of getting information from the IRS is insurmountable. I even went to an IRS office in the US personally during my vacation and waited for over 3 hours to ask a short question, to which they did not have an answer. It is impossible to get through to a human on the 1-800 number. To this day my question remains unanswered, and I pay 500 USD annually to a tax firm in order to file although I owe nothing each year. I have no idea why I have to do this. - Illinois voter (country of residence not disclosed)*

*It seems even paid tax preparers vary in their understanding of filing which tax forms, rules concerning war zone definitions, what constitutes a penalty and ultimately how the IRS notifies the tax payer in the event of discrepancies ( there is no viable public postal system in Kuwait ). - North Carolina voter living in Kuwait*

The quotes below are representative of the 2/3 who lamented that they have to file at all:

*Basically, it boils down to not understanding why it's necessary for me to file in the USA. My income and retirement savings have been taxed according to the tax laws in my current country of residence. What does that have to do with the USA? Why do I have to deal with the stress of filing when I've already taken care of it in the country where the money was made and where I live? I believe in supporting the government and economy - and I am doing so - in Luxembourg. My taxes go to help rebuild roads and fund public education, as well as many other state benefits for residents of Luxembourg. What does any of that have to do with the US? I am not a resident of the US. ... - Oregon voter living in Luxembourg*

*It is ridiculous how expats are penalized for living abroad. The IRS system is too complex, costly (esp with yearly preparation of reports and filings when no taxes are owed!). We have such stress of preparing accurate filings to declare every minute detail of our overseas income and accounts (with high penalties for filing errors) when none of our income and lives have anything to do with the US!! We are mostly just regular people living normal lives, not all rich, offshore tax avoiders! - Connecticut voter (country of residence not disclosed)*

*I earn a modest living. I have no investments, receive no dividends and possess no significant assets. Even my savings are relatively modest, which, even when combined with my salary, still don't reach the minimum income amount. I don't understand why the IRS has to keep tabs on someone like me. - Illinois voter living in Finland*

*It is unreasonable, and unprecedented among other developed countries, to expect me to file despite earning no income and owing no tax to US gov't. All income is foreign-earned and taxes are paid to that country.... - Georgia voter living in Spain*

*This is a question of violation of privacy, control over ones financial future, and of fairness. I am concerned for my dual [SIC] citizen children and what this means for their future. - California voter living in Australia*

*As an American living overseas for over 17 years and holding dual citizenship, I find it stressful and ridiculous that I have to continue to file my taxes in the US. Due to the complexity of it all, I pay a tax advisor £300 (nearly \$500) to help me file each year. I am*

*already taxed 40% on my earnings in the U.K. so this is just another unnecessary burden as far as I'm concerned, and it has even made me think about renouncing my American citizenship. - **Kansas voter living in the UK***

*Filing is a nightmare, and next to impossible to do so accurately given the differences in reporting by institutions, but the greater impact is on my ability to plan for my financial future, with the many restrictions and penalties on holding accounts and investing abroad, including in a pension fund. It is increasingly difficult to open bank accounts as well, due to the burden of the reporting requirements on local financial institutions. - **Iowa voter living in Spain***

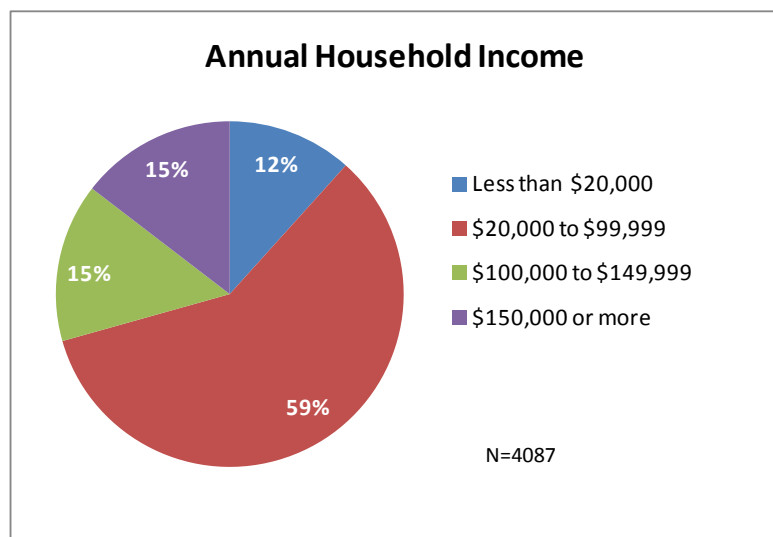
*It's more complicated to file taxes in the U.S. than in Italy, even though I ultimately owe nothing. The stress and cost of this is outrageous, especially considering that it ultimately is for absolutely nothing. It's heartbreaking, but I'm honestly not sure if I want my future kids to be dual citizens because I'd just be saddling them with the same stresses. – **Georgia voter living in Italy***

*All of our earnings are from within Ireland. Yet we have to report them to the IRS and, potentially, pay taxes on them to the United States???? We're trying to pay a mortgage, look after elderly parents, put our kids through school and college. And we stop what we're doing every summer and focus on meticulous box-filling for the IRS, when I haven't lived or worked in America for twenty four years. It is a very distressing experience. - **Connecticut voter living in Ireland***

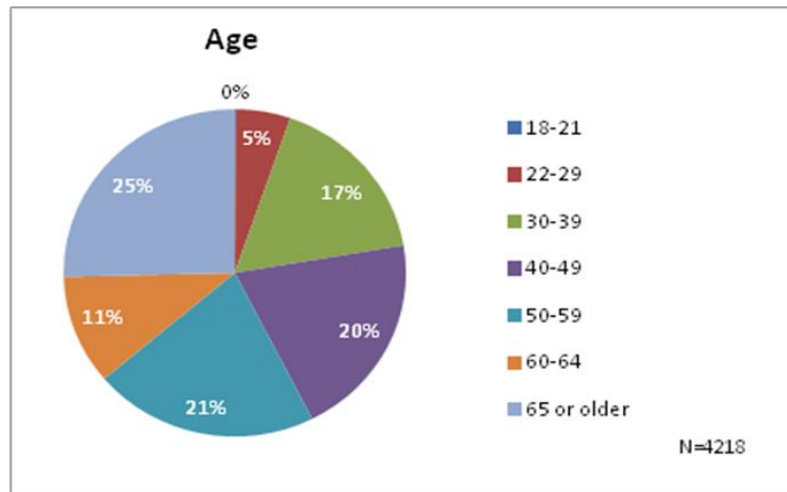
## Profiling Americans Abroad

Demographic data provided by survey participants indicates they are ordinary middle class Americans. The data cited within this section are included in full in Appendix IV.

- 68% are married
- **70% have income below \$100,000**
- 70% are employed or self-employed, working part time or full time
- 90% have earned a bachelor or higher degree



- 59% are female
- **25% are Age 65 or older**



Just under 60% of respondents were women, in line with the overseas population generally. Women living abroad often suffer special vulnerability due to tax consequences and to arrangements they make to protect their family assets from U.S. taxation.

*After leaving my German husband of 23 years, and struggling to make it with 3 hungry children in expensive Germany, the money i recieved [SIC] from my husband as alimony was all subject to American taxation, even though my husband already paid taxes on it. This money was also considered not part of the 90000 earnings that are exempt. This is a horrible injustice that is actually also unfair to the German state. – **Minnesota voter living in Germany***

*We decided to have my husband (non US) be the sole owner of our house in the UK so I could avoid US capital gains tax when we sell it. Not the best choice from an independence standpoint. We are also limited in how we invest in the UK because of PFIC. We also are concerned about what happens with my estate when I die as my husband is not a US citizen. – **Washington DC voter living in the UK***

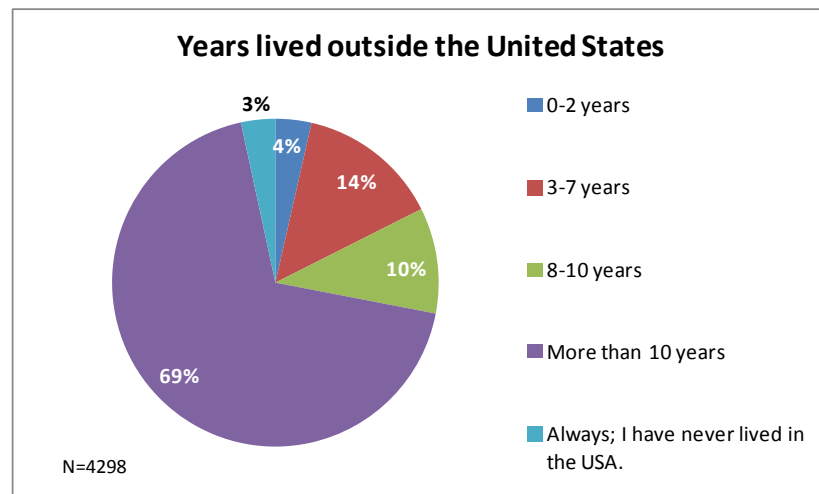
Respondents came relatively evenly from across the age groups, but the greatest proportion of submissions came from Americans over the age of 65. This suggests older Americans abroad may have slightly greater sensitivity to tax discrimination.

*I try to keep it simple. But our "government" keeps making it harder. At 72 years old I want things simple. The IRS, however, loves keeping it impossible to understand. - **Pennsylvania voter living in The Philippines***

*My foreign income is all passive now, having reached retirement. I cannot take advantage of the 2555 exemption for income only. My retirement income amounts to \$ 50,000, and last year I paid Italy € 18.000 of this, plus I had to pay a tax accountant \$1,400. I cannot afford this, and want either to try to do the return myself or give up my citizenship. It's a terrible reason to relequish [SIC] citizenship, and expensive, but in 2 years the cost would have been absorbed, thinking of having to pay so much every year in the future to get help. I never owe anything, it's just a stress and a waste of my resources. - **Virginia voter living in Italy***

## Tax issues impacting Americans abroad

- **69% have lived abroad for at least 10 years**
- **66% have no plans to return to the US to live**



Given that 69% of respondents have lived abroad for at least 10 years and that 66% have no plans to return to the U.S. to live, it is not surprising that the tax issue noted most frequently relates to the taxation of long term savings and retirement plans (48% of respondents).

*US taxation of earnings from foreign long-term savings plans and retirement fund are totally disadvantageous for those who live and work abroad, and do not follow same rules as for Americans with similar plans in the US. It is as if the IRS wants to punish us from using savings and retirement plans in the countries where we work and live. – **Massachusetts voter living in Denmark***

*Local law compels me to have a retirement account that is not a "qualified" US account and accounting for the earnings is a huge headache. It seems the earnings do not qualify for US treatment as retirement savings and so I must pay real cash tax on theoretical earnings that I can never touch (because they are locked "inside" the local retirement fund.) I have no idea how the US will handle the (eventual) payments from this fund. – **New York voter living in Hong Kong***

*US does not recognize the Swiss Pension plans - so tax is paid currently and again after retirement unless the US citizen returns to the US. Not a very realistic option for most who have lived abroad their entire lives. - **Kentucky voter living in Switzerland***

*US citizens are not able to benefit from tax free savings accounts in their resident countries, because US does not recognize tax free status of such accounts, nor can a US non-resident contribute to his/her US retirement account if one does not pay US federal income tax (e.g. because taxes in resident country are higher). US citizens resident abroad are therefore discriminated against and stripped of their rights to a tax free savings account, just because of their choice of where they reside. - **Illinois voter living in Germany***

**Reduced Access to Financial Products and Services** was the second most noted issue - an outcome of FATCA and new efforts to enforce the Bank Secrecy Act, USA PATRIOT Act and certain Securities & Exchange Commission regulations.

*I am incredibly concerned with how to invest as an expat. I don't make a lot of money, but I will have to find and pay for a financial consultant to advise how I can save for retirement, kids' education, etc., as well as whether or how my only residence will be affected by the US*



*tax code. This is exacerbated by the difficulty in finding someone local who has that expertise. All of this puts a strain on me and my spouse, and makes our future seem uncertain. - Florida voter living in Canada*

*In addition to foreign banks declining us as clients, several US banks have declined working with us for investment purposes, leaving us with nowhere to invest our money despite the fact that we are following all the rules! We do not get 401ks as expats so retirement savings is on us. It is unfair and unethical that US financial institutions are denying US expats as clients unless they can commit to multimillion dollar investments. - Maryland voter living in the United Arab Emirates*

*I am unable to access the majority of "normal" investment products for basic college/retirement savings in either the UK or US due to my US citizenship. This will have an even greater impact on my children, who will be unable to live normal lives from a tax/savings point of view as dual US/UK citizens living abroad. It is such a terrible situation that I am seriously considering revoking my US citizenship and my children's. I have always filed my US taxes, but the cost (thousands of dollars every year) to file returns for which I don't owe the US government a penny in the end is also a very unfair and unnecessary burden. - Massachusetts voter living in the UK*

**Capital Gains Tax Treatment of Non-US Property Sales and PFIC (Passive Foreign Investment Company) Rules on Non-US Investment Funds** were other problems noted by a large proportion of respondents.

*PFIC rules are punitive, nearly impossible to understand, and make it virtually impossible to invest in funds in my country of residence -- but investing in funds in the US is also now virtually impossible for non-residents due to tightened rules. How are we supposed to save for retirement under this outdated, punitive and completely unfit-for-purpose regime? FATCA has also limited my access to financial products and services. - Utah voter living in Norway*

*The most unfair experience I have had - was on the sale of a non US property. We are not allowed to deduct interest payments on mortgages for non US property purchases - as the property is not in the US. US residents get this amazing advantage which reduces their tax burden over the years they take to purchase their homes. However, even tho [sic] as non US residents we are not allowed the interest deduction, we are then charged at the same rate as US residents for capital gains. Also, if our spouses are not US citizens - then we only receive 50% of the approved capital gain allowance per sale. We are punished in so many ways for marrying a non US citizen. This is also true regarding bequests - if I was married to a US citizen my assets upon death would transfer to my spouse freely. As I am married to a non US citizen - my death would create a huge tax burden for my spouse. This is when ALL the assets that I would be transferring at death were earned in my country of residence - and I have not lived in the US or used a US service in over 32 years. I am clearly living in a foreign country for family reasons. - New York voter living in Australia*

*PFIC treatment of foreign mutual fund investments made decades ago came out of the blue 5 years ago. In the late 90s this was on no one's radar. Even though the law hasn't changed, the enforcement/interpretation change has caught many long term expats by surprise; a very costly surprise! - Missouri voter living in Australia*

*After investing in a PFIC and later understanding the tax consequences it was one of the most terrifying / stressful experiences I have had. US tax law makes it extremely prohibitive for US citizens to invest outside of the USA. - Washington voter living in Singapore*

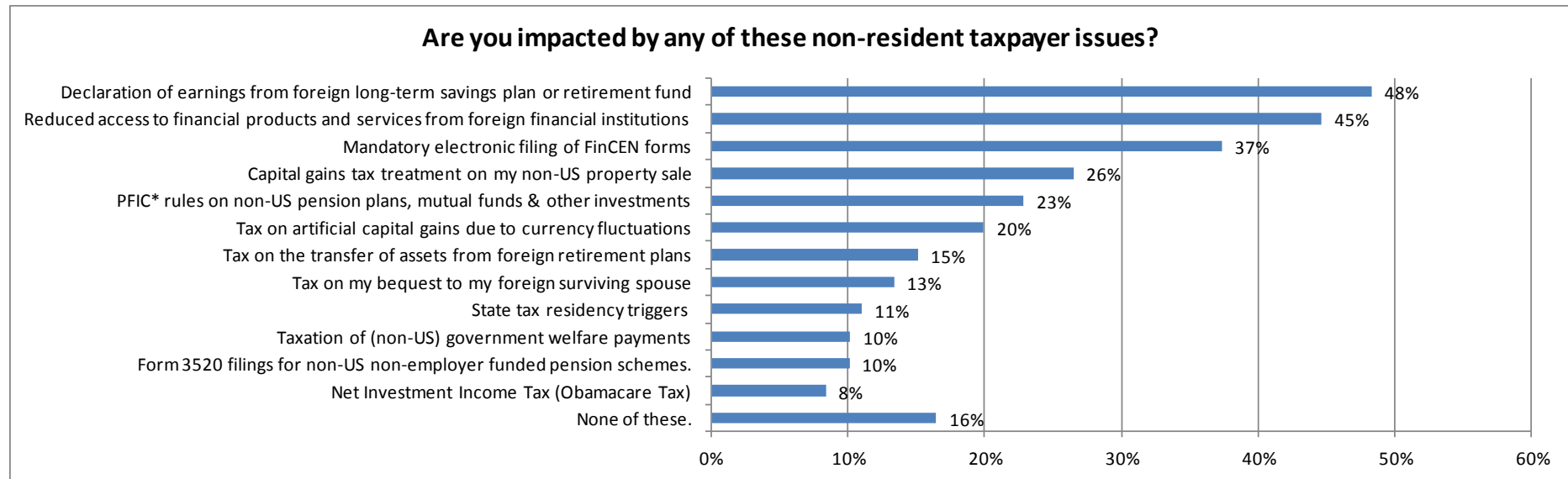
*Recognising unrecognised capital gains on non-US funds (PFIC treatment) is grossly unfair. As is paying tax on distributions from non-US pension funds but not being able to declare the tax paid when the funds were deposited. - Pennsylvania voter living in Australia*

*Our family has been forced to completely rearrange all our savings in order to avoid PFIC rules on what would, if I was in the US, be a completely ordinary mutual fund savings*

*account. Also the US taxation of UK benefits that are paid tax-free in the UK is particularly galling; what possible right can the US government have to that money? - **Massachusetts voter living in the UK***

Together these testimonials underscore the problems of double or punitive taxation by the U.S. tax code and the difficulties faced by non-resident Americans trying to save for their future. The extent to which respondents are impacted by 12 specific tax matters known to affect Americans abroad is summarized in the graph below.

Appendix V includes quotes from survey respondents that relate to these and other tax problems.



This table explains the tax matters included in the survey.

<u>Declaration of Earnings from foreign long-term savings plans and retirement funds</u> – earnings are taxed annually rather than upon withdrawal.	<u>CGT treatment on sale of non-U.S. primary home property</u> - ineligible for the \$250,000 or \$500,000 exclusion available to taxpayers disposing of U.S. primary home.	<u>Tax on the transfer of assets from foreign retirement plans</u> – U.S. tax imposed when assets are shifted to a U.S. retirement plan or other country retirement plan	<u>Taxation of (non U.S.) Government welfare payments</u> – invalidity, unemployment and other social welfare payments not taxed in country of residence by taxed by the U.S.
<u>Reduced access to financial products and services</u> – occurring since Foreign Financial Institutions started reporting the accounts of US Persons under F.A.T.C.A rules.	<u>Passive Foreign Investment Company rules for non-U.S. pension plans, mutual funds, other investments</u> – includes a range of punitive taxes and onerous reporting obligations to discourage investments not subject to U.S. taxation.	<u>Tax on my bequest to my foreign surviving spouse</u> – foreign spouses are not afforded the marital deduction in the calculation of estate tax that U.S. spouses are entitled to.	<u>Form 3520 filings for non-U.S. non-employer funded pension schemes</u> – treats pension scheme deposits under the rules for declaring and taxing foreign gifts.
<u>Mandatory Electronic filing on FinCEN forms reporting foreign bank accounts</u> – starting in 2014	<u>Tax on artificial capital gains due to currency fluctuation</u> – taxed even if there is no currency exchanged.	<u>State tax residency triggers</u> – non-resident taxpayers imposed state tax on offshore earnings, eg home ownership	<u>Net Investment Income Tax</u> – no foreign tax credits to offset 3.85% Affordable Care Act tax. (Irony that non-resident Americans are ineligible for Obamacare.)



## ADDRESSING TAX ISSUES IMPACTING AMERICANS ABROAD

There are other issues impacting Americans abroad besides those included in the survey. Appendix I and II to this report include reform recommendations prescribed by Democrats Abroad for the tax filing and financial account reporting issues we have identified. Appendix III outlines the range of tax and regulatory rules that harm Americans saving and investing for retirement or currently in retirement.

As noted in the introduction to this report, rather than asking lawmakers and regulators to wrestle separately with the range of deep complexities that arise when an individual is subjected to taxation by two countries, most all issues can be solved at once by reforming the Internal Revenue Code to exempt the reporting of non-US income of Americans resident abroad, thereby adopting a standard system of Residency-Based Taxation.

84% of our survey respondents favored a switch from our current system of Citizenship-based Taxation to Residency-Based Taxation.

*I am retired. All my income comes from the USA, namely, SS and IN teacher's pension. Therefore I think it's only fair that I pay US income tax. If I earned income abroad, it would be different. - Indiana voter living in Costa Rica*

### Implementing Residency-Based Taxation

Individuals would need to satisfy bona fide foreign residency and perhaps other criteria in order to qualify for Residency-Based Taxation. However, if the implementation model for RBT contains provisions that make it difficult or disadvantageous for Americans abroad to achieve eligibility, the issues listed in these appendices would continue to afflict these citizens living abroad. Qualified filers may need to opt in or opt out each year, so some simplified form of annual reporting might be necessary. And, of course non-resident taxpayers who opt in to RBT would continue to report their US-source income annually.

Further, Democrats Abroad restates its published view that any package of tax reforms will only be deemed acceptable if it **helps reduce inequality, boost opportunity** and raise revenue predominantly from those with the greatest ability to pay. We will support common sense reforms, like RBT, that **clarify and simplify filing** and make the tax code fairer for all Americans. The advantages of changing from Citizenship Based Taxation to RBT, however, **must primarily benefit ordinary Americans living and working abroad**. And, it **must not open tax avoidance loopholes** or otherwise include avenues for high net worth taxpayers to abuse for the purposes of tax avoidance.

## APPENDIX I

### TAX CODE PROVISIONS THAT DISCRIMINATE AGAINST AMERICANS ABROAD

**Note:** Residency-Based Taxation would resolve most of the issues listed in this appendix.

In our examination of the provisions in the Internal Revenue Code that govern tax filing and reporting for non-resident Americans we have identified the areas shown below that require remedies in order to address the unintended, adverse consequences that arose for Americans abroad when the code was written.

- **US Capital Gains Tax Exclusion** – harmonization of capital gains treatment for properties owned by citizens living abroad with the treatment of properties owned by citizens living in the US.
- **Artificial Capital Gains/Losses due to Currency Fluctuations** – elimination of artificial capital gains and losses when no currency has been exchanged by allowing the currency of the country of residence to be the functional currency for tax reporting purposes.
- **Applying foreign credits to NIIT** – allow Americans abroad to apply foreign income tax credits in calculating Net Investment Income Tax
- **Marital deduction for bequests to foreign surviving spouses** – reinstate the marital deduction for bequests to surviving foreign spouses in the calculation of estate tax.
- **Declaration of foreign long term savings plan income** – tax the income from foreign long-term savings plans at the time the money is withdrawn from the plan.
- **Taxation of welfare payments** – tax foreign government invalidity, unemployment and social welfare payments to disabled and disadvantaged Americans abroad only by the country making the payments, i.e. the country of residence.
- **Tax-free transfer of foreign retirement plan assets** – render tax-free the transfer of assets from foreign retirement plans deemed qualified plans under international tax treaties to retirement plans in the taxpayer's new country of residence, be it the US or another country.
- **Revise punitive PFIC rules** – For citizens residing abroad revise the punitive Passive Foreign Investment Company rules and reporting requirements that apply to non-US pension plans, foreign mutual funds and other investment savings vehicles that prohibit Americans abroad from saving effectively for retirement.
- **Taxation of non-US non-qualified pension plans** – simplify the reporting structure for non-US, non-qualified pension plans that would alleviate the onerous need for Form 3520 filings for non-employer funded pension schemes.
- **Reforms to the FEIE and FHE** – maintain the Foreign Earned Income Exclusion, merge it with the Foreign Housing Exclusion and eliminate the ceiling. This would completely eliminate double taxation of earnings of non-resident taxpayers.
- **Repeal WEP** – Replace the Windfall Elimination Provision (WEP) which drastically reduces the Social Security payments owed to Americans also receiving foreign pension payments with the Social Security Fairness Act to restore rightful Social Security payments to Americans abroad.

## APPENDIX II

### IMPROVING TAX FILING AND REPORTING FOR AMERICANS ABROAD

Although these reforms would lose their importance for most Americans abroad under Residency-Based Taxation, they would be enormously helpful for those who elect not to become non-resident US citizens for tax purposes.

- **Optional simplified earnings declaration** – provide non-resident taxpayers who owe no US federal income tax with the option of a one-sentence, handwritten or printed declaration of earnings, accompanied by a tax return or assessment from the taxpayer's country of residence
- **Expand the criteria for determining the threshold for who has to file** – add a provision so that foreign earned income that can be excluded under current rules does not need to be included when determining your gross income for filing purposes.
- **Make electronic tax return filing possible for non-resident taxpayers declaring foreign tax credits** - Allow taxpayers using the free, fillable IRS electronic forms to exclude the attachments eliminating the need for the taxpayer to file the return by post.
- **Translated IRS publications and forms** – provide translated versions of IRS publications and tax forms commonly used by non-resident, non-English speaking US citizens.
- **Remove FBAR filing requirement for FATCA filers** – the disclosures made on the FBAR foreign financial account report established under the Bank Secrecy Act are duplicated on the FATCA Report. Not all foreign financial account holders will have balances that exceed the FATCA reporting threshold, but there should be no FBAR filing requirement for those who do.
- **Harmonize International Tax Treaties** – align all international tax treaties with the US Model Income Tax Convention of November 15, 2006, especially (but not exclusively) as they apply to private pensions, social security benefits, annuities, alimony, child support and pension plans.
- **Promote the Streamline Filing Compliance (Offshore) Procedures (SFCP)** – expand awareness of the SFCP, a tax amnesty program introduced in 2014 for Americans who non-wilfully are not compliant with their tax filing and reporting obligations.
- **Improved communication** – encourage the IRS to do even more to expand communication with Americans living abroad, starting with the reopening of its overseas offices and the restoration of offshore services lost due to cuts in IRS funding.
- **Protect American Citizens Services** – ensure that proposed cuts to State Department funding do not result in further reductions in American Citizen Services provided by US consulates and embassies, which often include advice about tax filing deadlines and support services .

## APPENDIX III

### REGULATIONS CONSTRAINING BANKING, INVESTMENT AND RETIREMENT SAVINGS FOR AMERICANS ABROAD

**Note:** Residency-Based Taxation would resolve most of the issues listed in this appendix.

Investment options for Americans abroad are increasingly limited and fraught. Due to legislation designed to protect consumers in the market for financial products, a provider of financial fund products must be registered to sell and market their products in a foreign jurisdiction. Although U.S. brokerage firms have over time turned a blind eye to this requirement, more recently, in an atmosphere of increased disclosure and oversight, many have elected to prohibit clients residing abroad from buying U.S. mutual funds in order to avoid the registration requirement. Exchange-Traded Funds are a legal work-around for Americans abroad interested in a mutual fund-type investment exposure, however even Exchange-Traded Funds may not be an option for individuals whose foreign and/or U.S. bank and brokerage accounts have been closed.

Features of the U.S. tax code impacting investments, savings plans and retirement savings uniquely penalize Americans residing abroad in the following ways:

- Punitive taxation of retirement savings plans which qualify and are taxed under local laws but are not qualified plans for U.S. tax purposes;
- Punitive taxation of foreign government sponsored retirement savings plans that are not qualified plans for U.S. tax purposes;
- Capital gains tax laws that do not take into account currency fluctuations, thereby creating assessable capital gains upon the sale of assets even if no currency was exchanged;
- The inability to claim the foreign tax credit against taxes owing under the Affordable Care Act, the 3.8% Net Investment Income Tax;
- Inflexible regulations involving Social Security and Medicare contributions particularly disadvantage (double-tax and other) self-employed Americans abroad.
- The Windfall Elimination Provision which drastically reduces the Social Security payments owed to Americans also receiving foreign pension payments;
- The Social Security benefit taxation regime for taxpayers who are Married Filing Separately provides no exclusion for spouses. Americans married to foreign nationals normally file as Married Filing Separately and as such cannot receive the exclusion afforded Americans married to Americans who file jointly;
- Social Security contributions required of self-employed Americans abroad are taxed (15.5%) even if they are already making contributions to an aged pension contribution scheme in their country of residence;
- Welfare payments made by foreign governments to Americans who are disabled, unemployed or disadvantaged are subject to US tax though they are normally not taxed abroad.

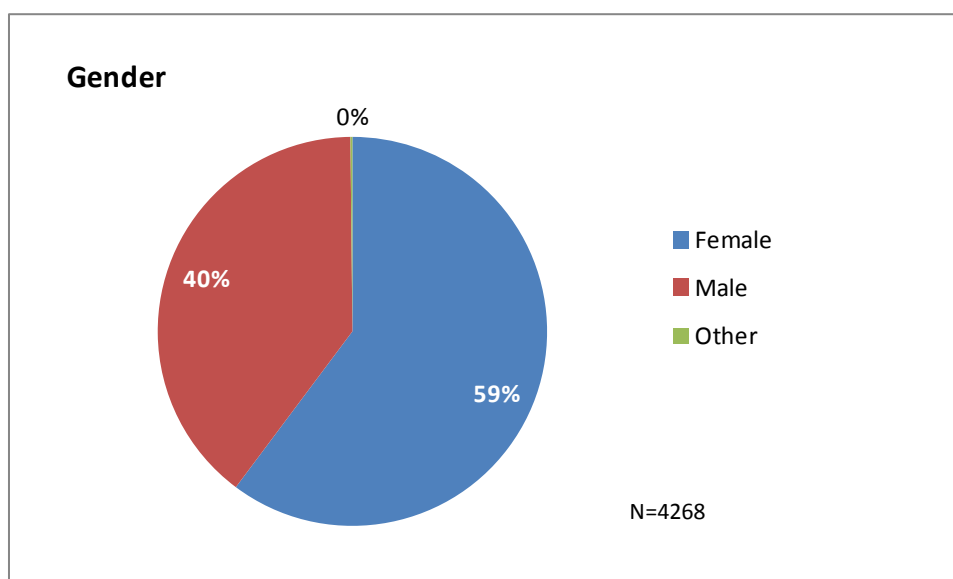
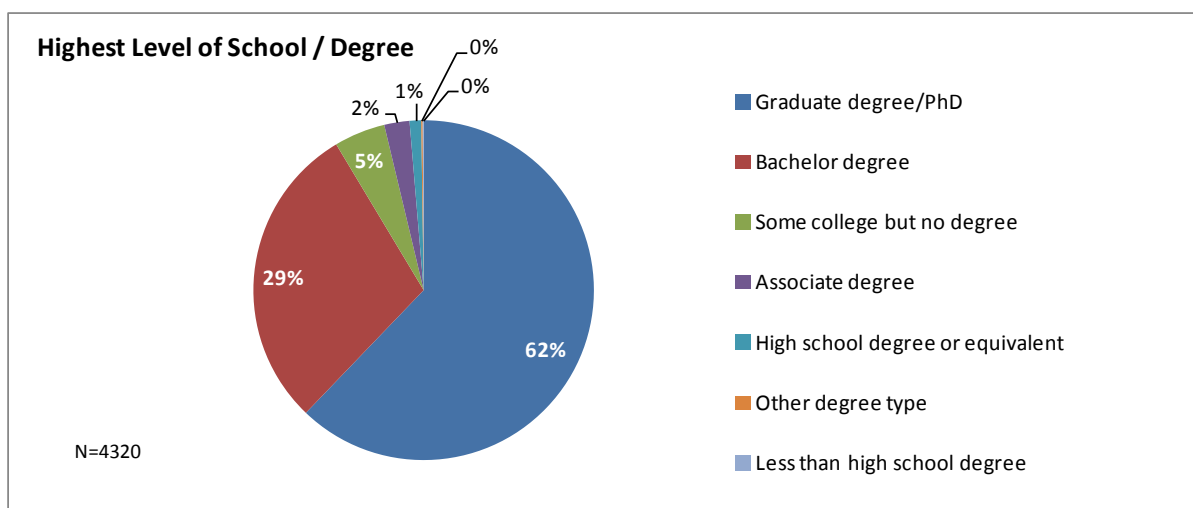
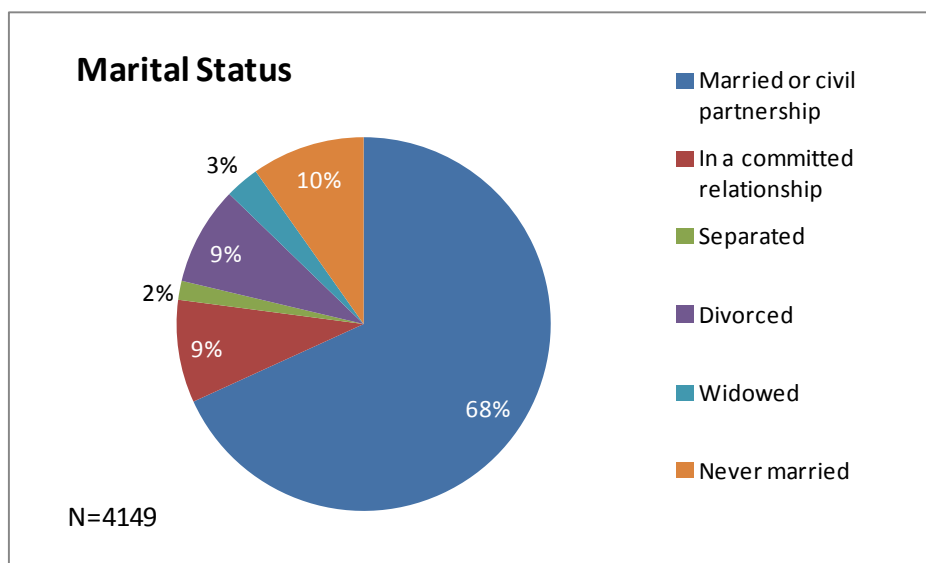
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U.S. BANKING ALSO CONSTRAINED

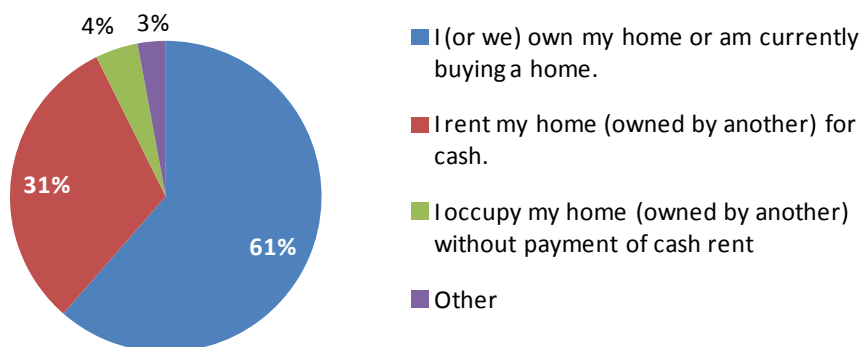
The USA PATRIOT Act, ratified after the terrorist attacks of 9/11, established new “Know Your Customer” rules for US financial institutions. As a result, banks and financial institutions are no longer willing to hold or open accounts for customers whose only address is outside of the United States. This has constrained the banking, saving and investment activities of Americans abroad. A sensible reform would be to exempt American citizens living abroad from this provision even if they have only a non-US address.

## APPENDIX IV

### SURVEY FINDINGS

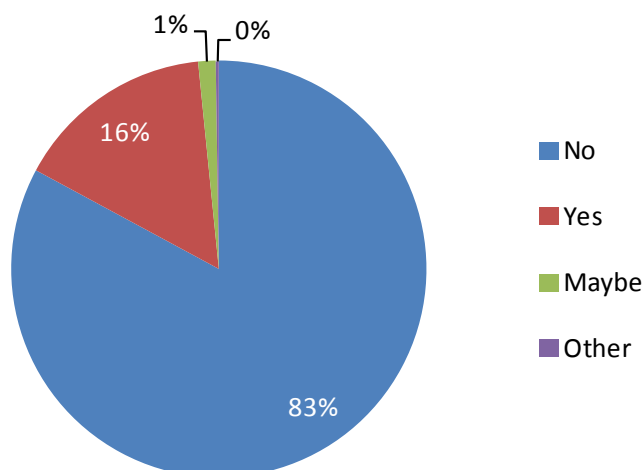


## Home Ownership



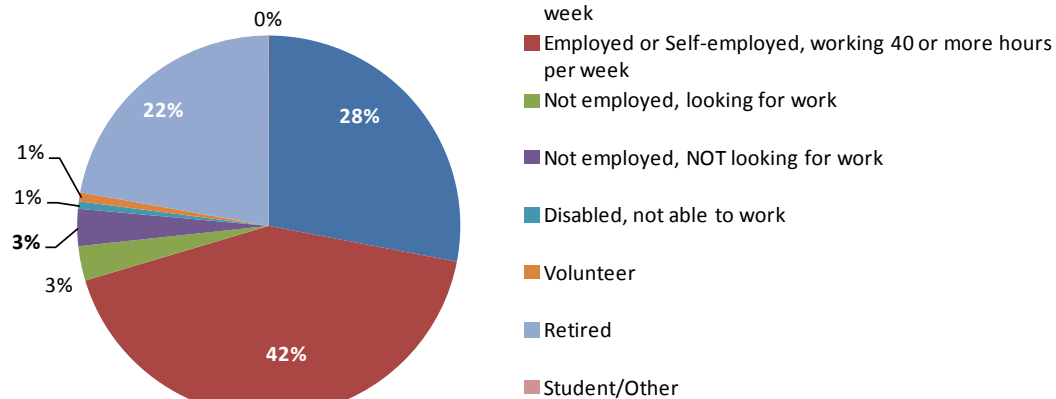
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## Do you own a Business or Farm?

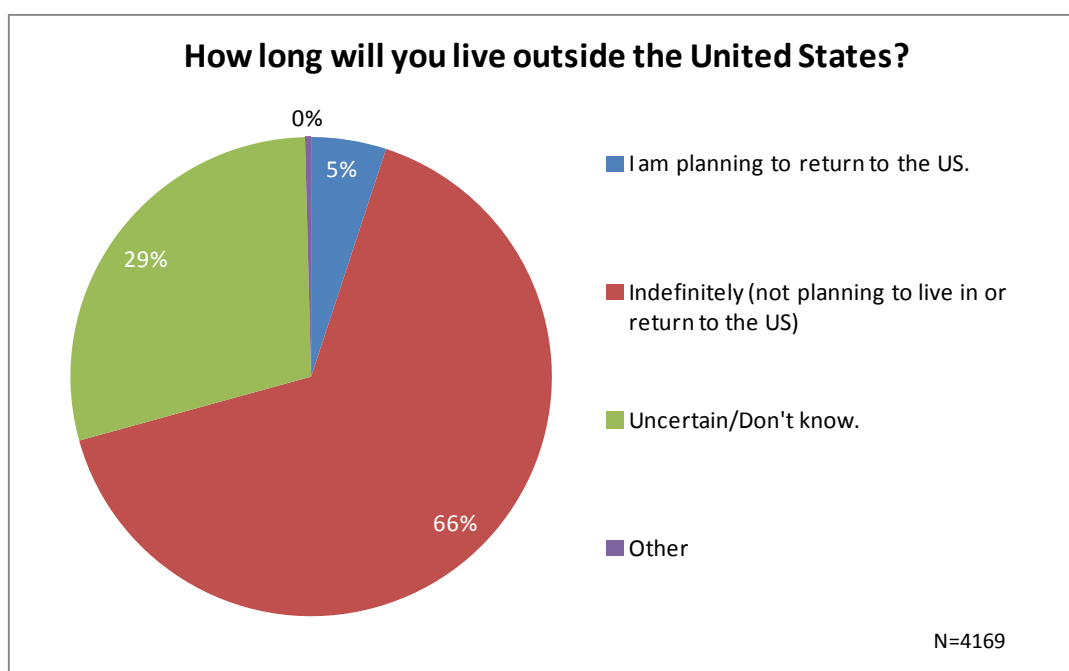
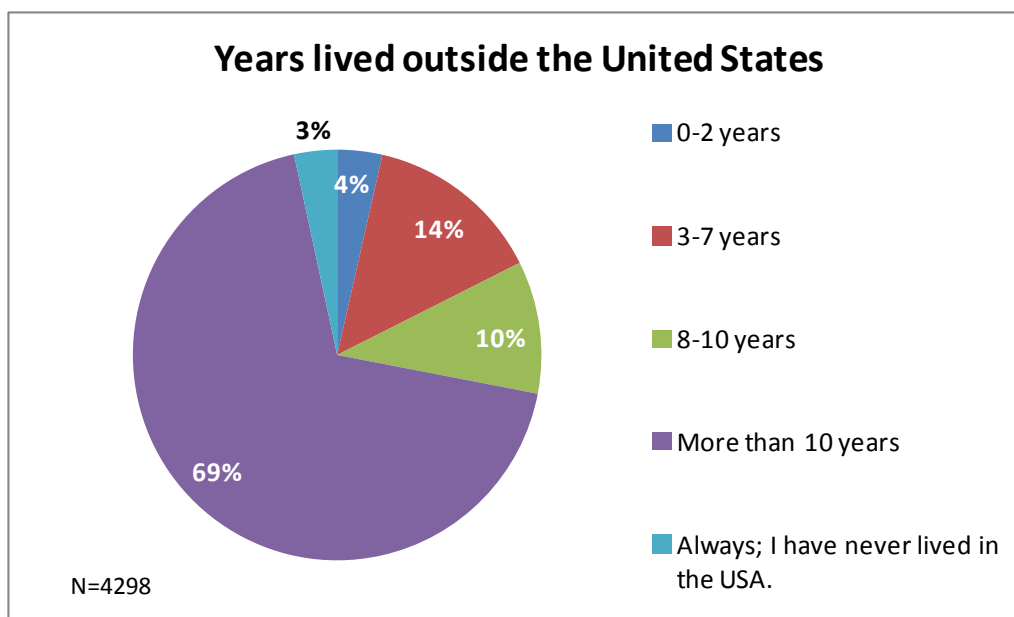


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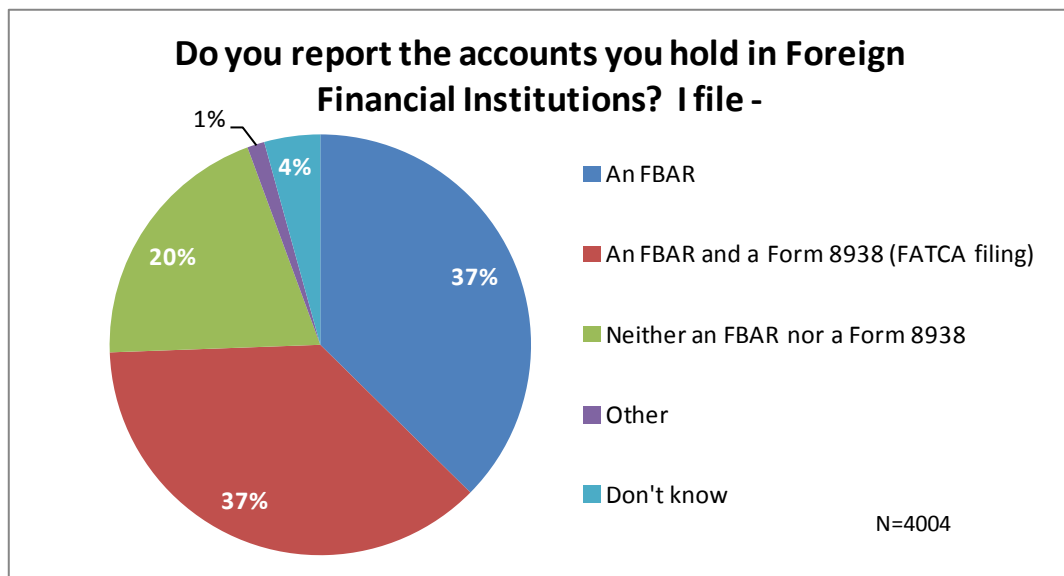
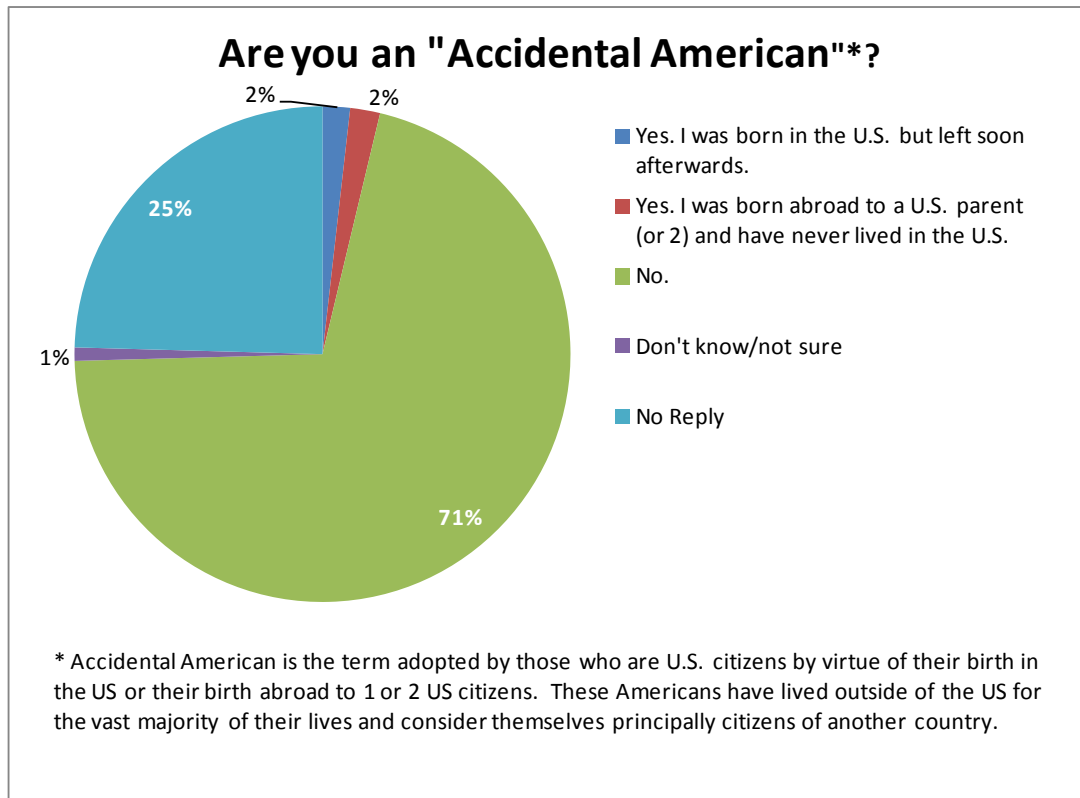
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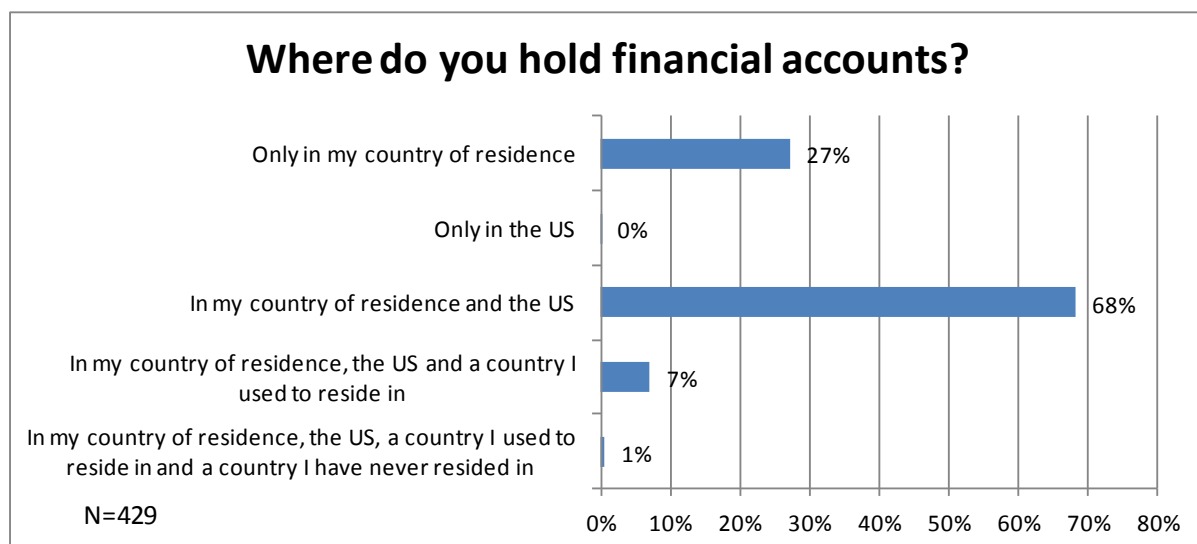
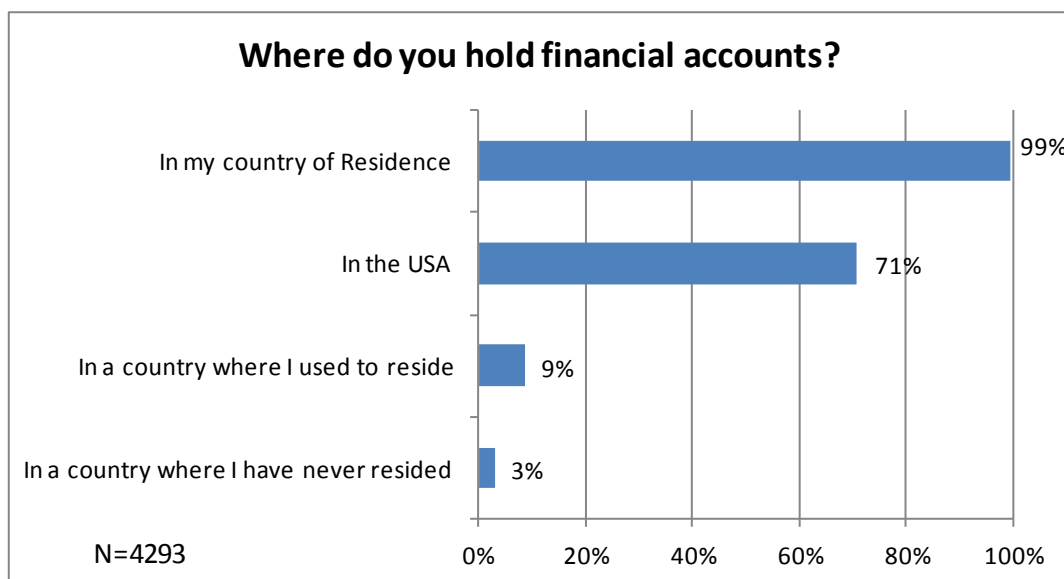


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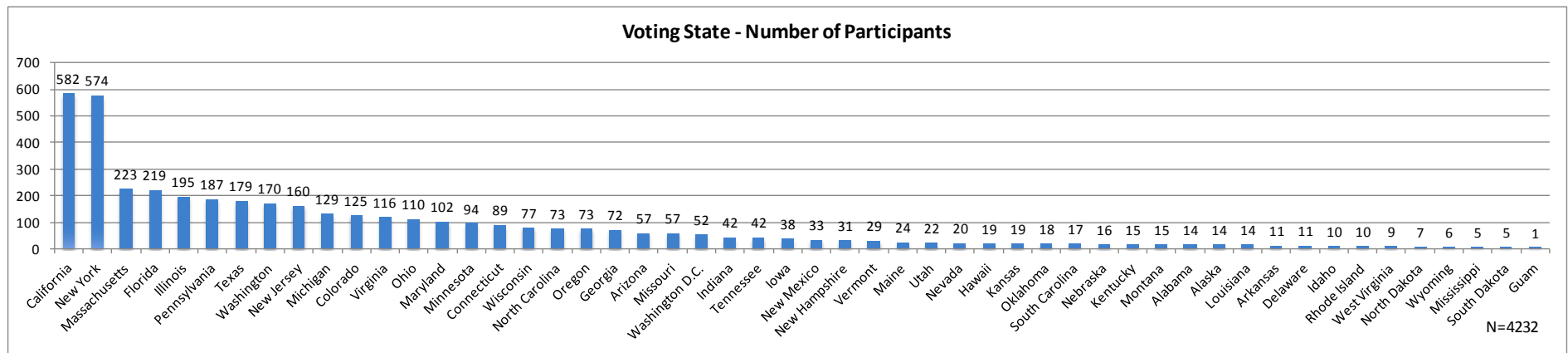
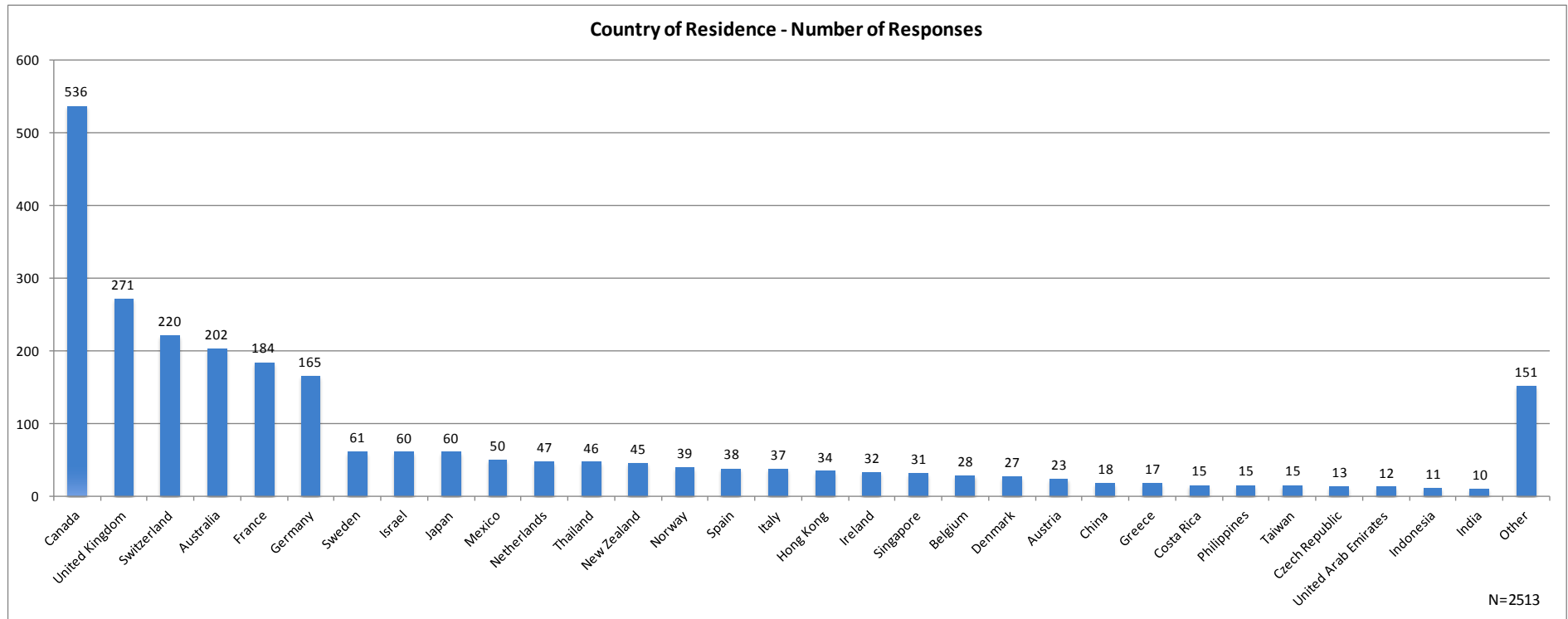








## Can we please stop paying twice? Reforming the tax code for Americans Abroad



## APPENDIX V

A few tax matters raised by a large number of respondents to the survey were not profiled or not fully profiled in the report but deserve mention. These are some of the comments collected.

U.S. tax on non-US government social welfare payments (eg for citizens who have disabilities, are unemployed, indigent, at university or aged or other):

*I was laid off from my job and received severance and unemployment benefits which were taxed at a low rate in France. Because this income is considered "unearned" by the IRS, it cannot be covered by the Foreign Earned – **Oregon voter living in France***

*I was forced to voluntarily cash out a Netherlands tax-deferred severance pay account because US law required that the severance pay be taxed immediately while the Netherlands would only tax distributions in the (distant) future. This timing discrepancy made it impossible to make use of what was then a common tax deferment vehicle and resulted in the entire severance pay being taxed at the Netherlands rate of 52%. – **New York voter living in The Netherlands***

*I receive a scholarship from the Canadian federal government that is not taxed in Canada. I have to pay full taxes on this to the US, which is money going from the Canadian taxpayer (via the government) to the US government. I get a full refund in Canada and then pay several thousand dollars in [tax to] the US as a full-time student. - **New York voter in Canada***

Tax on bequests to foreign surviving spouse which are tax exempt for U.S. surviving spouses:

*Right now, thankfully, "Tax on my bequest to my foreign surviving spouse" is merely a potential matter, but my spouse has never lived in the U.S. and should never, ever, be punished for the happenstance of marrying a U.S. citizen. Absurd, absurd, absurd. – **California voter living in Japan***

Tax on artificial gains due to currency fluctuations which are unrealized gains because no currency was exchanged when the proceeds were generated:

*My biggest complaint is the currency fluctuations which can cause large shifts in the amount of tax I owe, even though to me my income is unchanged. Also selling my house in Vancouver caused a large capital gain for me but I still had to buy back into the same market so the gain was really a gain. I had to pay my taxes from my retirement savings. - **Ohio voter living in Canada***

15.5% payroll tax (taxes that pay for Social Security and Medicare, also known as FICA and taxed at a employer/employee combined rate of 12.4% for Social Security up to a cap of \$127,200 and 1.45% for Medicare with no cap) owed by self-employed non-resident taxpayers, even if they make mandatory contributions to statutory aged pension programs to their country of residence:

*I resent the fact that 15.5% of my gross self-employment income goes to the USA. I also resent that rental income ends up double-taxed. I resent being treated like a criminal, filing reports to the Financial Crimes Enforcement Network of the Treasury Department. I resent the fact that my retirement account will be taxed as a lump sum windfall when I retire, even though the money put in it was not tax-deferred. I could go on. I simply resent the entire US attitude toward taxation of those who don't live there. – **Oregon voter living in Hong Kong***