American Citizens Abroad

Side-By-Side Analysis:

Current Law; Residency-Based Taxation

5 December 2016; 1 November 2017; 1 December 2017; 18 January 2018; 19 April 2018; 20 April 2022

INTRODUCTION

This side-by-side analysis compares Current Law (i.e., citizenship-based taxation rules in the Internal Revenue Code) and one possible approach to Residency-Based Taxation ("Vanilla Approach"). The column labelled "Current Law – Citizenship-Based Taxation" summarizes present law. Changes made by the Tax Cuts and Jobs Act (TCJA, P.L. 115-97, 12/22/2017) are taken into account. The column labelled "Residency-Based Taxation – Vanilla Approach" describes one possible approach to taxing US citizens and resident aliens according to their residency rather than citizenship. This approach sets forth a detailed version of possible new statutory and treaty rules, which then can be modified as desired. It also serves as a starting point for the preparation of revenue estimates.* IT IS NOT A LEGISLATIVE PROPOSAL.

Current Law – Citizenship-Based Taxation	Residency-Based Taxation – Vanilla Approach
US citizens and resident aliens, including "green card" holders, residing overseas are taxed the same as these individuals residing in the US (generally referred to as "citizenship-based taxation" ("CBT")). Special provisions can provide some benefits for foreign earned income and certain housing costs. Special rules, including a mark-to-market rule (exit tax), can apply to individuals who renounce US citizenship or relinquish their green card.	US citizens, but not "green card" holders, residing overseas ("non-resident Americans"), in general, would be removed from the category of individuals subject to US income tax and, generally speaking, placed in the same category as nonresident aliens (foreign individuals). Various conforming changes would be made. This approach is commonly called "residency-based taxation" ("RBT").
Taxpayers/Affected Individuals	Taxpayers/Affected Individuals
For federal income tax purposes, US citizens and resident aliens generally taxed on worldwide income regardless of source of income or other factors.	For federal income tax purposes, US citizens taxed on residency basis, i.e., generally taxed only on US source income and income effectively connected with a US trade or business. These individuals are hereinafter referred to as "non-resident Americans". Individual's tax home must be in a foreign country, and he must be a *bona fide* resident of a foreign country. See section 911(d)(1)(A) & (d)(3). Also, see 5-year "aging rule", below. This means, among other things, that the individual has not stated to the authorities of the foreign country that he is not a resident of that country, and he is required to pay income tax there at generally applicable rates. Someone living in a foreign country on a tourist or visitor visa or pursuant to a so-called "Golden Visa" would not qualify. Someone holding a permanent resident visa typically would qualify. The individual might not qualify for section 911 treatment because, for example, he is retired and has no earned income.
Citizenship defined by nationality laws. Includes, with very narrow exceptions, all individuals born in the US regardless of nationality of parents; naturalized citizens; and certain individuals born overseas to a US parent. "Resident alien" defined by income tax rules in section 7701(b) (physical presence and "green card" test).	Same as current law.

Citizens and residents taxed on worldwide income at graduated rates on regular income rising through 7 brackets from 10% to 37%, with variations depending upon filing status, i.e., married filing joint returns and surviving spouses, heads of household, unmarried individuals, married individuals filing separate returns. Taxed on worldwide adjusted net capital gains generally at 0%, 15% or 20%. For example, for joint filers and surviving spouses, for 2018, 0% tax rate applies gains up to $77,200. Figures are adjusted for inflation after 2018. A 3.8% net investment income tax can apply where modified adjusted gross income exceeds $250,000 for joint returns and surviving spouses, $125,000 for separate returns and $200,000 in other cases, bringing overall rate to 23.8%. Changes to individuals' rate structures "sunset" (no longer apply) beginning 2026. A standard deduction amounting to $12,000 for individuals, $18,000 for heads of household, and $24,000 for married couples, is provided. The personal exemption which existed prior to TCJA is eliminated. Number of itemized deductions are eliminated or limited by TCJA.	Same as current law.
Subpart F can tax on a current basis or sometimes differ tax on income of a controlled foreign corporation. TCJA adopts a modified form of territorial taxation allowing a deduction for dividends received by a corporate US shareholder from a specified 10% owned foreign corporation under a new participation exemption system. US taxpayers residing abroad do not benefit. A special "transition tax" can apply to previously tax-deferred earnings and profits, and this tax can apply to US taxpayers residing abroad. A new "downward attribution" can subject an individual, such as an American abroad, to the "transition tax" by attributing, for the first time, shares owned for example by a related foreign person to the individual in question.	Same as current law except dividends received deduction pursuant to participation exemption system applies to non-resident Americans. Transition Tax does not apply to non-resident Americans.
Enacted as part of TCJA was a 20% deduction for certain income of so-called pass-through entities. This benefit does not apply in the case of foreign income.	Non-resident Americans are excepted from the rule that foreign source income does not qualify for the 20% deduction.
Special tax rules can apply to individuals who expatriate, including mark to market rules (so-called "exit tax"; sections 877 & 877A). Deduction for tax preparation services – eliminated. Deduction for mortgage interest – limited to an underlying indebtedness of up to $750,000 ($350,000 for married taxpayers filing separately. State and local income and property tax deductions collectively limited to $10,000 per year and foreign real property taxes may not be deducted. Child tax credit is increased to $2000 per child, refundable up to $1400, subject to certain phase-out thresholds. (Child tax credit can be used offset NIIT tax.)	Non-resident Americans not subject to "exit tax", but see Transition Tax Provision, below.

Non-US citizens and non-resident alien individuals generally subject to US withholding tax, at 30% rate or reduced rate pursuant to a treaty, only on certain US source income, including interest (other than so-called "original issue discount"), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other "fixed or determinable annual or periodical gains, profits". Also, subject to graduated rate of tax, same as US citizen or resident on income effectively-connected with a US trade or business. Section 871(a) & (b). Income from US real property generally taxed under Foreign Investment in Real Property Tax (FIRPTA) rules (§897); collected by withholding. Capital gains, except capital gains non-resident aliens present in the U.S. 183 days or more during the taxable year, are generally exempt from tax under the Internal Revenue Code. Foreign tax credits can be claimed to offset US tax, but not to the extent of foreign taxes that are allocable to income excluded under foreign earned income exclusion (see below).	Non-resident Americans (US citizens), in general, are subject to taxation the same as non-resident alien individuals. Normal sourcing rules in the Internal Revenue Code and bilateral income tax treaties, including provisions for reduced withholding tax rates, apply. §§861-865. US source income is taxed under rules applicable to non-resident aliens. §§871-898. Likewise, effectively connected income (ECI) (§871(b)) and Foreign Investment in Real Property Tax (FIRPTA) rules (§897) are applicable. 30% withholding is imposed on certain withholdable payments under FATCA if the payee doesn't provide required documentation. There is withholding on effectively connected income of foreign partners in a partnership. Capital gains, as with non-resident aliens, are generally exempt, except in the case of non-resident Americans present in the US 183 days or more. Foreign tax credit rules are not changed, except carrybacks and carryforwards are limited as set forth below. The "savings clause" in treaties, which preserves the U.S.'s right to tax its citizens and residents wherever they reside, is inapplicable. However, in order to claim treaty benefits, such as reduced withholding rates, an individual would have to be resident for treaty purposes, typically meaning subject to tax there. See, for example, Article IV 1. (Residence), U.S.-Canada Income Tax Convention.
Social Security benefits are included in gross income in any year the sum of half the taxpayer's Social Security plus all other income, including tax-exempt interest, exceeds $25,000 if single, head of household, qualifying widow(er), married filing separately ($32,000 if married filing jointly). They are reported on a Form SSA-1099 issued by the Social Security Administration. Taxes withheld only if requested by the recipient.	Social Security benefits taxed as US source income and are subject to withholding, as with non-resident alien individuals. Section 871(a)(3). Treaty provisions apply where individual is entitled to claim treaty benefits. Recipient provides SSA with Form W-8BEN (revised to reflect enactment of RBT) claiming status as non-resident American.
Generally, early withdrawals (before age 59½) from an IRA or retirement plan are taxed with a 10% early withdrawal tax. Required minimum distributions from IRAs, but not Roth IRAs, beginning at age 70½, are taxed as ordinary income.	Early withdrawals and required minimum distributions are generally taxed as US source income and subject to withholding. Treaty provisions apply where individual is entitled to claim treaty benefits.
	Pension distributions for services performed in the U.S. are treated as U.S. source income and subject to tax This applies whether the distribution is made under a qualified or nonqualified stock bonus, pension, profit-sharing, or annuity plan (whether or not funded). Individuals can opt out of residency-based taxation (RBT) by not applying for a Departure Certificate (see below). Residency-based taxation is not available to members of the armed services and diplomatic corps or with respect to any amount paid by the U.S. or an agency thereof to an employee.

	Special definitions and other rules in bilateral income tax treaties apply to non-resident taxpayers that otherwise qualify under the treaty's provisions. "Savings clause" does not apply. Individuals resident in a "tax haven" country would not qualify for RBT. Treasury is authorized to designate "tax haven" countries and to exclude from the list countries where the presence of US citizens is determined to be of strategic importance. Residency in a "sanctioned country" does not qualify for purposes of residency-based taxation rules.
No provision tied to "tax haven" status applies to individuals.	Income from a "sanctioned country" does not qualify for residency-based taxation treatment. In order to qualify for residency-based taxation, an individual must have met the bona fide residency test (see above), for the most recent 5 taxable years prior to the year of claiming non-resident American status ("aging test"). Non-resident Americans who have qualified for RBT will become subject again to worldwide taxation under normal rules if they meet requirements similar those applicable to nonresident alien individuals under section 7701(b)(1)(a)(ii) ("Substantial presence test").
Special Rules for Citizens or Residents Abroad	Special Rules for Citizens or Residents Abroad
Section 911	Section 911
US citizens and resident aliens can qualify for exclusion from taxable income comprised of eligible foreign earned income exclusion and a housing cost amount under section 911. In order to qualify for section 911, residency test must be met. Individual's "tax home" must be in a foreign country and the individual must be a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year or be present in a foreign country for at least 330 full days during a period of 12 consecutive months. Section 911. Foreign earned income exclusion annual amount is currently $102,100 (for 2017). Housing cost amount in general equals the excess of housing expenses over a figure tied to 16% of the salary of a US Government employee (Grade GS-14). Housing cost amount can be increased for certain locations with high housing costs compared to the US. E.g., Notice 2014-29, 2014-18 IRB 991.	Section 911 (including both foreign earned income exclusion and a housing cost amount) is not repealed; therefore, same as current law. (See "Effective Date; Transition Rules", below.)

Foreign earned income and housing expenses do not include income or expenses related to a “sanctioned country” (essentially a country that has been designated as repeatedly providing support for acts of international terrorism, one as to which the US has severed or does not conduct diplomatic relations, etc.). No requirement that to qualify for foreign earned income exclusion, individual must be subject to income tax in another country.	
Short-Turn Overseas Employment	Short-Turn Overseas Employment
No provisions.	No provisions. Individuals employed overseas for a short term who currently benefit from section 911 will not be adversely affected. Individuals claiming section 911 treatment will continue to be subject to existing income and estate tax rules and related reporting rules. Section 911 is not repealed. These individuals could simply not apply for a Departure Certificate, i.e., not place themselves under RBT.
Estate and Gift Taxation	Estate and Gift Taxation
For federal gift and estate tax purposes, US citizens and residents subject to gift and estate tax with respect to worldwide assets. Estates with combined gross assets and prior taxable gifts of $12.06 million (2022) or less are not required to file an estate tax return. Amount adjusted for inflation. Couples might be able to double this to $24.12 million. Citizenship defined by nationality laws. “Resident” generally defined by estate tax rules in regulations (Reg. §20.0-1(b) (essentially domicile, following common law principles)).	Estate of non-resident American taxed the same as estate of non-resident alien (i.e., taxed only on U.S. property).
Non-residents’ estates must file an estate tax return if the fair market value at death of the decedent's U.S.-situated assets exceeds $60,000. Substantial lifetime gifts of U.S. property by decedent can reduce this figure. Estate and gift tax applies to U.S. property including, only as to gift tax, shares in U.S. corporations. Cash deposits in U.S. bank accounts generally are exempt.	Same as current law ($60,000 threshold).
	In order to qualify, decedent must have qualified as a non-resident American for 3 years prior to date of death. Non-resident American generally taxed the same as non-resident alien individual under current gift tax rules. Donor must have qualified as a non-resident American for 3 years prior to date of gift. American outside the US for most recent three calendar years prior to year of enactment is treated as “non-resident”.

FATCA; Payroll Taxes	FATCA; Payroll Taxes
The “Hiring Incentives to Restore Employment Act” (“HIRE Act”), enacted in March 2010, included the “Foreign Account Tax Compliance Act” or “FATCA”. These provisions, among other things, created voluminous new Chapter 4 withholding tax rules. They also created the requirement for taxpayers to file a Statement of Foreign Financial Assets (Form 8938), overlapping, to a significant degree, the Foreign Bank Account Reporting requirements.	FATCA would not be repealed. A “same country” exemption for certain accounts of individuals residing in a foreign jurisdiction, where the account is with a foreign financial institution in the same country where the individual resides, would be added to the Internal Revenue Code. This helps US citizens resident abroad who for whatever reason are not “covered” by RBT rules. Rules underpinning Form 8938 would be changed: If an individual only had foreign deposit and custodial accounts, which had been reported on a Foreign Bank Account Report, he or she would not be required to file Form 8938. No changes in existing payroll tax rules.
Filing Requirement	**Filing Requirement**
Taxable citizens and residents must file a Form 1040 and, where applicable, a Form 2555 (Foreign Earned Income), Form 1116 (Foreign Tax Credit), Form 8938 (Statement of Foreign Financial Assets), and Form 8621 (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund). Non-US citizens and non-resident alien individuals must file a Form 1040NR if engaged in a US trade or if they received business or fixed or determinable annual or periodical gains, profits, e.g., interest, dividends, etc., that were not withheld upon. The FIRPTA tax is collected by withholding (§1445). No filing required with respect to US capital gains.	Non-resident Americans are generally treated as non-resident aliens and, therefore, do not file Form 1040, Form 2555, Form 1116, Form 8938, or Form 8621. File Form 1040NR if required to report US source income. Qualifying individuals wishing to be taxed on a residency-basis are required to apply to the IRS for a Departure Certificate. Non-resident taxpayer status commences with date of Departure Certificate. Foreign financial institutions are entitled to treat an individual as not subject to FATCA reporting provided they obtain a valid Departure Certificate. This is similar to treatment of individuals who renounce citizenship and file a Form 8854. Year of issuance of Departure Certificate is a split year, and individual files a dual return (Form 1040NR and Form 1040).

	Non-resident taxpayers with effectively connected income file a version of Form 1040NR. Any individual claiming Residency-Based Taxation must file an annual certification stating under oath that he/she is a US citizen or resident alien, fulfils the residency requirements for the taxable year (including the 5-year rule, above), continues to reside as stated in his or her Departure Certificate (or if not, provides new information), does not reside in a "tax haven" country, and does not have income related to a "restricted country". Failure to file annual certification terminates status as non-resident American.
Transition Tax Provision	Transition Tax Provision
A US citizen who renounces or a long-term US resident who relinquishes residence status and who meets certain tests is treated as a "covered expatriate". All property of such individual is treated as sold on the day before the expatriation date for its fair market value ("exit tax"). The first $600,000 (adjusted for cost-of-living increases; $699,000 for 2017) is excluded. Sections 877 & 877-A.	Individual obtaining a Departure Certificate and meeting the threshold test (see below), and thus changing his/her status from individual subject to tax due to US citizenship, to individual taxable under RBT rules, is subject to tax ("Transition Tax") on income as if property was sold on the day before the date of the Departure Certificate.
Threshold tests are individual has average annual net income tax of greater than $124,000 (adjusted for cost-of-living increases; $162,000 for 2017) over most recent 5 years or a net worth of $2,000,000 or individual fails to certify under penalty of perjury that he or she is tax compliant for the 5 preceding taxable years.	Threshold tests are same as those in section 877, except $2 million figure in section 877(a)(2)(B) increases to $3 million and US real estate subject to FIRPTA rules is excluded. Rules similar to those in sections 877 and 877A applicable to pensions and other forms of deferred compensation apply. US real estate subject to FIRPTA rules is excluded. Special Rule ("Grandfather" Rule) for Individuals Residing Abroad. Individuals meeting the residency test for residency-based taxation for at least 3 years prior to date of enactment of these rules and who certify under penalty of perjury that they have been tax compliant, would not be subject to the Transition Tax.
Portfolio interest, on certain debt structured to benefit only non-U.S. persons, is exempt from withholding. Section 871(h)(2). Similarly, certain interest-related dividends of regulated investment companies are exempt. Section 871(k).	Individuals subject to the Transition Tax, as to portfolio interest, would not qualify for portfolio interest treatment under section 872(h)(2) and, as to interest-related and short-term capital gain RIC dividends under section 872(k), would not qualify for the subject exemption.
Bequests and gifts to US persons from "covered expatriate" are taxed to recipient at highest estate tax or gift tax rate.	No provision. Non-resident American is not treated as a "US person".
State Department fee of $2,350 charged for renunciation.	One-time IRS User Fee equal to the State Department's then applicable renunciation fee. Americans abroad qualifying for the special 3-year rule, above, would not be subject to this user fee.

Effective Date; Transition Rules	Effective Date; Transition Rules
	RBT is effective as of date of enactment, for taxable years following date of enactment. In first year that individual holds a Departure Certificate, days spent in the US do not count for determining status as resident. Beginning date for residency-based tax status is date of issuance; it cannot be retroactive to an earlier date. Foreign tax credit carrybacks and carryforwards are extinguished as of this beginning date. Residency-based taxation, in effect, may be elected for a taxable year by an eligible individual by obtaining a Departure Certificate. Status as a non-resident American remains in effect so long as the individual qualifies and files annual certification that he/she qualifies, until the individual files with the IRS a request for termination of election and such request is approved. If individual has fulfilled applicable requirements, he/she can immediately claim residency-based tax treatment for any taxable year following the effective date. Such treatment cannot be claimed for past open years.
Anti-Abuse Rules	Anti-Abuse Rules
	Gain from sale or disposition of securities for a 3-year period following issuance of a Departure Certificate remains taxable as under current law, regardless whether linked to prior employment in the US. Thus, if an individual residing in the US moves abroad (changes US residence to a foreign residence) and sells or disposes of securities within 3 years of obtaining a Departure Certificate, gain will remain subject to US tax. (Individuals exempt from the Transition Tax under the Grandfather Rule, above, would be exempt.) Issuance of a Departure Certificate requires proof that individual is a resident of a foreign country and is subject to taxation in that country on the same basis as others who are residents there. Issuance of a departure certificate requires proof of payment of all US income tax liabilities. Individuals eligible for the special rules for individuals residing abroad, above, would be subject to the Transition Tax, whether or not they are tax-compliant. The date of departure for such individuals is the subsequent date of issuance of the Certificate. If an individual who was a non-resident American for any of the immediately prior 5 years and was a resident American for any year prior to that period, and

	again becomes a resident American, then he or she will be treated as a resident American for each of the prior years as to which, absent this rule, such individual would be treated as non-resident. Otherwise, a returning Non-Resident American will be treated the same as a non-resident alien who becomes a resident alien for US tax purposes. Treasury Department is authorized to prescribe rules necessary to carry out the RBT provisions.
FBAR Filing Requirement	FBAR Filing Requirement
US persons, including individuals, companies, partnerships, trust, estates, etc., are required to file annually Foreign Bank Account Reports if they meet certain threshold tests relating to ownership and "signature power" and size of the account. Individual includes US citizen or resident alien as defined in section 7701(b).	Same as current law.

*This Side-By-Side Analysis was first published 5 December 2016 and has been revised as shown above. This analysis was prepared by Charles M. Bruce, Legal Counsel, American Citizens Abroad, Inc. He is solely responsible for any errors. Comments, questions and corrections, all of which will be greatly appreciated, should be directed to charles.bruce@americansabroad.org.

"He" should be read as "he" or "she".

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