

TAX SIMPLIFICATION FOR AMERICANS ABROAD ACT OF 2023
TECHNICAL EXPLANATION
BY AMERICAN CITIZENS ABROAD
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Introduction

On September 13, 2023, U.S. Representatives Don Beyer (D-VA) and Dina Titus (D-NV) introduced [H.R.5432], the Tax Simplification for Americans Abroad Act of 2023. This document¹ provides an explanation of the Tax Simplification for Americans Abroad Act (H.R.6057), which was introduced November 19, 2021.

It was prepared by American Citizens Abroad, Inc. (“ACA”).²

ACA is a membership organization incorporated as a nonprofit organization under the laws of the State of Delaware. It is an exempt social welfare organization (I.R.C. § 501(c)(4)). Alongside it is American Citizens Abroad Global Foundation (“ACAGF”), which is a publicly-supported charity (I.R.C. § 501(c)(3)). ACA and ACAGF favor a balanced approach to subjects, supporting efforts that provide tangible results. Both are nonpartisan. They do not provide tax, legal, accounting, or investment advice or services. For additional information and to join, go to www.americansabroad.org.

Present Law

US Citizens. Americans are taxed on the basis of their citizenship, not residency. A US citizen, no matter where he or she resides and regardless of the type and source of income, is subject to US federal income tax, if certain income thresholds are met, and that individual must file a tax return with all the associated forms and schedules and, as called for, pay tax. One of the associated forms requires reporting of information about Specified Foreign Financial Assets, including foreign deposit and custodial accounts and certain other foreign assets.³ Special rules provide, as part of the regular income tax return, a foreign earned income exclusion, which can include a housing cost amount.⁴ (This exclusion, in effect, is a type of partial residency-based tax treatment for some individuals.) Foreign tax credits, generally, can be claimed to offset US tax, but not to the extent of foreign taxes that are allocable to excluded income.⁵ Upon an individual's death, if the individual was a US citizen, his or her estate, if it is of a certain size, must file an estate tax return and pay estate tax with respect to its worldwide assets. Similarly, a US citizen is generally subject to gift taxation regardless of where the individual resides and where the assets are situated. Other special rules deal with the tax treatment of expatriation. In addition, if certain thresholds are met, a US

¹ This document can also be found on the American Citizens Abroad website at www.americansabroad.org. All section references in the document are to the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise stated. ACA wishes to thank Representative Beyer's staff for its assistance.

² The author is Charles M. Bruce, Legal Counsel, ACA, and Chairman, American Citizens Abroad Global Foundation. He is solely responsible for any errors. Comments, questions, and corrections should be directed to him at charles.bruce@americanabroad.org. Marylouise Serrato, Executive Director, ACA, and Carmelan Polce, ACA Executive Committee Member, contributed to this writing.

³ Form 8938, Statement of Specified Foreign Financial Assets (<https://www.irs.gov/pub/irs-pdf/f8938.pdf>).

⁴ Section 911 (Citizens or residents of the United States living abroad).

⁵ Section 901 (Taxes of foreign countries and possessions of United States); Form 1116 (Foreign Tax Credit (Individual, Estate, or Trust)).

citizen and a US resident is required to report to the Treasury Department foreign bank account information.

Other countries, with very few exceptions, only tax residents of that country, that is, an individual is not subject to the country's normal panoply of tax rules if he or she resides outside the country. The individual commonly remains taxable on income sourced or arising in that country.

Non-US Citizens. Non-US citizens and non-resident alien individuals are generally subject to US withholding tax, at a 30% rate or reduced rates pursuant to a bilateral 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" (FDAP income).⁶ Also, they are subject to graduated rates of tax, same as US citizens or residents, on income effectively-connected with a US trade or business. Section 871(a) & (b). Their income from US real property is generally taxed under Foreign Investment in Real Property Tax (FIRPTA) rules⁷; this is collected by withholding. Capital gains, except capital gains of nonresident aliens present in the US 183 days or more during the taxable year, are generally exempt from tax under the Internal Revenue Code.

There are many details affecting these subjects, but this is the general "lay of the land."

Tax Simplification for Americans Abroad Act of 2023 (H.R.5432)

In general, the Tax Simplification for Americans Abroad Act ("TSAA") mandates that a simplified income tax form be made available for certain taxpayers residing abroad, expands for eligible individuals the scope of income allowed to be excluded from tax under existing section 911 (Citizens or Residents of The United States Living Abroad) and changes the Bank Secrecy Act/anti-money laundering rules⁸ and the tax reporting rules enforced by Form 8938 (Statement of Foreign Financial Assets). Use of the new simplified form is not mandatory; individuals can choose not to use it. The BSA/AML and Form 8938 rules are applicable not just to individuals residing abroad but to all individuals.

Short income tax form for certain taxpayers living abroad

TSAA mandates that the Secretary of the Treasury make available to specified US taxpayers (referred to as "specified individuals") a simplified form to report tax imposed by chapter 1 of the Internal Revenue Code.⁹ This is not an amendment to the Internal Revenue Code, rather it is an instruction to the Secretary to do certain things.

Such simplified form "shall replace" Forms 1040 (US Individual Income Tax Return), 2555 (Foreign Earned Income), 1116 (Foreign Tax Credit), 8938 (Statement of Specified Foreign Financial Assets), 5471 (Information Return of US Persons With Respect To Certain Foreign Corporations), 3520 (Annual Return To Report Transactions With Foreign Trusts And Receipt of Certain Foreign Gifts), 3520A (Annual Information Return of Foreign Trust With US Owner), 8621 (Information Return By a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund), 8858 (Information Return of US Persons With Respect To Foreign Disregarded Entities and Foreign

⁶ As of 2023, the US has income tax treaties in force with 46 countries.

⁷ Section 897 (Disposition of investment in United States real property).

⁸ 31 USC 5311 et seq. The foreign Bank Account Reporting (FBAR) provisions spring from these sections of the US Code, not the Internal Revenue Code, which sits in Title 26 of the US Code.

⁹ Chapter 1 of the Internal Revenue Code apparently refers to chapter 1 of Subtitle A (Income Taxes). Chapter 1 deals with Normal Taxes and Surtaxes. It does not deal with other subjects, such as, taxes to enforce reporting on certain foreign accounts (Chapter 4; these are the Foreign Account Tax Compliance Act (FATCA) rules, which are principally withholding tax rules.) and Consolidated Returns (Chapter 6). Nor does it deal with estate and gift taxes, which appear in Subtitle B. Included in Subtitle B are special rules for gifts and bequests from expatriates. Form 708 (US return of tax for gifts or bequests from so-called "Covered Expatriates"), which is not published as of this date, results from these special rules.

Branches), 8865 (Return of US Persons With Respect To Certain Foreign Partnerships), 965 (Inclusion of Deferred Foreign Income Upon Transition To Participation Exemption System), and 708 (this form, which would report so-called “covered gifts and bequests”, has not been published as of this date). The simplified form shall also replace FinCEN Form 114 and “other forms for disclosing income, assets, deductions, and offsets.” It shall be “similar to” Form 1040-EZ as that form existed in 2017.¹⁰ The form shall be “sufficient to allow” an individual to demonstrate that he or she is a qualified individual under section 911(d)(1), to declare foreign income described in section 911, to characterize income based on source (such income shall include wages, self-employment income or business income, contracting foreign government benefits, pension and other retirement income, scholarships and fellowship grants, interest, dividends, and capital gains), to claim the standard deduction and child tax credit, to declare foreign taxes paid or accrued, and to declare US source income from retirement, pension and Social Security benefits to be treated “as sourced [resourced] from treaty income where tax [of a foreign country] has been paid on distribution.”¹¹ (See provision including Social Security in the definition of earned income, below.)

A specified individual who is eligible to use the new simplified form is (a) a “qualified individual” under section 911(d)(1) and (b) declares gross income of not more than \$400,000 and tax liability of \$0.¹²

The existing rules attached to section 911(d)(1) are unchanged. These include, for example, the requirement that the taxpayer's tax home must be in a foreign country throughout the period of bona fide residence or physical presence abroad. Generally, this requirement is not met if the individual's “abode” is in the US.¹³

Expansion of income excludable as foreign earned income

TSAA amends section 911 (citizens or residents of the United States living abroad) to include in the term “foreign earned income” the amount received by the taxpayer from sources within a country or countries which constitutes earned income attributable to services performed by such individual or benefits received by such individual during the relevant period. Whereas in the past earned income included only income attributable to services, now certain benefits, *i.e.*, pensions, scholarships, fellowship grants, distributions from retirement funds, and payments received with respect to disability, unemployment, family medical leave, and childcare, are covered. Social Security benefits are a type of retirement distribution. The requirement that these amounts be received from sources within a foreign country(ies) remains intact. The sourcing [resourcing] rule, above, is intended to solve the problem of income not being foreign sourced.¹⁴

The effective date of these provisions is taxable years beginning after the date of enactment.

¹⁰ Form 1040-EZ was eliminated by the 2017 Tax Cuts and Jobs Act as Congress endeavored to simplify the basic Form 1040 for some filers. The form is two pages in length including some brief instructions and a worksheet. The instructions are 45 pages in length. <https://www.irs.gov/pub/irs-prior/f1040ez--2017.pdf>; <https://www.irs.gov/pub/irs-prior/i1040ez--2017.pdf>.

¹¹ Social Security benefits are an example of one type of income which is taxable. Regardless of where a US taxpayer resides, Social Security income is subject to reporting and tax; a portion might be excludable; and amounts can be withheld and reported to the IRS. As for the requirement that income tax be paid on the distribution, additional information may be forthcoming in the legislative process or Treasury Department regulations following enactment. This new form shall be made available for taxable years beginning one year after date of enactment of this Act.

¹² The \$400,000 amount is adjusted for inflation beginning in taxable year 2025.

¹³ For an explanation of these rules, see IRS 2022 Publication 54 (Tax Guide for U.S. Citizens and Resident Aliens Abroad), beginning at page 11. <https://www.irs.gov/pub/irs-pdf/p54.pdf>. These rules can be especially troublesome for taxpayers living near the US-Mexico or US-Canada border.

¹⁴ Query what results when benefits, such as social security benefits, arise with respect to an individual who resides in the country where there is no treaty with the US. Can benefits be “resourced” and thus made excludable where there is no treaty?

Changes in Bank Secrecy Act/anti-money laundering rules and Form 8938 tax reporting rules

Section 4 of TSAA makes changes in the Bank Secrecy Act/anti-money laundering rules in Title 31 of the US Code, not the Internal Revenue Code, and the tax reporting rules in section 6038D of the Internal Revenue Code, which are implemented by Form 8938 (Statement of Foreign Financial Assets, attached to Form 1040). The BSA/anti-money laundering rules are sometimes referred to as the FBAR rules. The section 6038D rules are sometimes referred to as the FATCA reporting rules.

If a person makes an FBAR-reportable transaction which involves a specified foreign financial asset transaction covered by the FATCA reporting rules, the FBAR reporting rules shall apply only if the amount in question exceeds the aggregate value threshold in section 6038D.¹⁵ Additionally, reporting is satisfied by attaching to such person's tax return for the taxable year the information required under section 6038D. A separate FBAR report is not required. For purposes of this FATCA reporting rule, the term "specified foreign financial asset" shall have the same meaning as it has in the FATCA reporting rules found in section 6038D(b).¹⁶

Threshold amounts are indexed for inflation starting with taxable years after 2024.

Added to the FATCA reporting rules is an exemption for accounts the maximum balance of which does not exceed \$600 for the entire taxable year, the usage of which is limited to a single merchant, or the account is of a type which is listed as exempt in Annex II of the FATCA Intergovernmental Agreement (IGA) in effect between the US and the country in which the account is held. For example, certain retirement, disability, or death benefits funds can fall within this category. Similarly, certain so-called narrow participation retirement funds. There are additional types of accounts. The details can vary from one IGA to another.

Foreign financial institutions that submit FATCA reports to the IRS are newly required to provide a copy to the account holder within 15 days of submission to the IRS.

The Treasury Department, upon written request, shall furnish to the Financial Crimes Enforcement Network (FinCEN) information from a taxpayer's Form 8938 "but only to the extent necessary in investigating suspected money laundering for the financing of terrorism.

Regulations

Under generally applicable rules, the Secretary of the Treasury shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of these new Bank Secrecy Act and anti-money laundering rules and the new tax reporting.

Revenue Costs

No revenue estimates were available as of the date of introduction.

¹⁵ Under existing rules, different thresholds apply depending upon whether the taxpayer is a specified individual (US citizen, resident alien, certain nonresident aliens) or a domestic entity. Also, for US citizens, the reporting threshold varies according to whether the individual lives in the US or outside the US. For example, taxpayers living outside the US, who are married and file joint tax returns, the reporting threshold is met if the total value of specified foreign financial assets is more than \$400,000 on the last day of the tax year or more than \$600,000 at any time during the tax year.

¹⁶ Covered are financial accounts in a foreign financial institution and, although not held in an account of a financial institution, stocks and securities issued by a non-US person, financial instruments or contracts held for investment that has an issuer or counterparty which is not a US person, and any interest in a foreign entity.