



April 6, 2022

To:

The Honorable Ron Wyden
Chairman - Senate Finance Committee
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Mike Crapo
Ranking Member - Senate Finance Committee
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Re: Hearing with IRS Commissioner Rettig on the IRS, the President's Fiscal Year 2023 Budget, and the 2022 Filing Season

Dear Chairman Wyden, Ranking Member Crapo, and Members of the Committee:

In light of the enormous challenges facing the Internal Revenue Service (IRS), we greatly appreciate you holding this important hearing. There are an estimated nine million American citizens residing outside the United States,¹ the overwhelming majority of whom are working or middle class.²

In the context of the 2023 Budget "Green Book", our comment **makes a number of recommendations that would alleviate unintended tax-filing and financial-access problems that Americans abroad face as a result of the current system of extraterritorial taxation (i.e., Citizenship-Based Taxation)**. The U.S., Eritrea, and North Korea are the only countries using such a system.

Going beyond the Green Book, **we urge the Senate Finance Committee to hold a hearing specifically to examine the unintended consequences of the current tax code on non-resident citizens and consider changing this system**. We would welcome engagement with individual Committee Members to discuss opportunities to introduce reforms.

¹ The U.S. Department of State's Bureau of Consular Affairs. (2020, January). Consular Affairs By The Numbers. Retrieved April 5, 2022, from <https://travel.state.gov/content/dam/travel/CA-By-the-Number-2020.pdf>

² Democrats Abroad. (2019, March 1). *Tax filing from abroad - 2019 Research on Non-Residents and U.S. Taxation*. Page 4. Retrieved April 5, 2022, from <https://democratsabroad.atlassian.net/wiki/download/attachments/4257416635/Tax%20filing%20from%20abroad%20-%20202019%20Research%20on%20Non-Residents%20and%20US%20Taxation.pdf?api=v2>

Green Book Recommendations

The Department of the Treasury's Fiscal Year 2023 proposals make a number of recommendations that are likely to impact Americans Abroad. In particular, they are:

- *Raising the Corporate Tax Rate to 28 Percent*, Page 2
- *Address Compliance in Connection with Tax Responsibilities of Expatriates*, Page 87
- *Simplify Foreign Exchange Gain or Loss Rules and Exchange Rate Rules for Individuals*, Page 90
- *Provide for Information Reporting by Certain Financial Institutions and Digital Asset Brokers for Purposes of Exchange of Information*, Page 97

Our commentary and recommendations on each proposal are as follows:

Raising the Corporate Tax Rate to 28 Percent

Commentary: How Americans Abroad are impacted by the change

- Non-resident U.S. citizens who operate small businesses in their country of residence are subject to the GILTI tax on undistributed earnings unless they qualify for a high-tax exemption depending on tax rates in their country of residence. At the current 21% rate, income taxed at 18.9% or more is excluded from U.S. taxation. At a corporate rate of 28% the foreign tax rate would need to be as high as 25.2% to qualify for the exclusion.

Our Recommendation:

- GILTI was designed to encourage large multinational corporations to move their operations back to the U.S., but this is not an option for small-business owners who reside outside the U.S., and they can seldom afford the accounting support which is required for compliance. U.S. citizens not residing in the United States should be exempted from GILTI.

Addressing Compliance in Connection with Tax Responsibilities of Expatriates

Major Changes:

- Adjustments to the statute of limitations ensure compliance and administrability

- The Secretary of the Treasury will be granted limited authority to relieve certain dual citizens from Covered Expatriate tax obligations

Commentary:

- We encourage lawmakers to read the motivation for this proposal that the Treasury provides on Page 88; it identifies the excessive compliance burden that the U.S. extraterritorial tax regime places on lower- and middle-income individuals, the pervasive financial-access issues, and the limited value to the IRS.
- We note that denial of financial services and excessive compliance burdens are problems that broadly affect all Americans residing abroad, not just those with minimal U.S. ties.
- We note that bank account closures and refusals are not limited to only those without SSNs / TINs. In some cases, foreign financial institutions demand to see a "Certificate of Loss of Nationality" for any U.S.-born individual, available only after someone expatriates. Such financial institutions deny or close accounts based solely on US Tax Residency.
- While we are supportive of relief for those with minimal U.S. ties, we are dismayed to see that there appears to be greater support for facilitating renunciation of American citizenship than there is for addressing the problems that force individuals into such an action.

Our Recommendations:

- We support the enactment of H.R. 5799 The Overseas Americans Financial Access Act as a way to address the denial of service faced by non-resident citizens.
- To address financial access issues, we would encourage the adoption of a strengthened "Non-Discrimination Clause".

Simplify Foreign Exchange Gain or Loss Rules and Exchange Rate Rules for Individuals

Major Changes:

- Annual average exchange rates, rather than spot exchange rates, become an option for tax calculations
- Exemption from foreign currency gain is increased from \$200 to \$500
- Foreign currency losses become deductible against any gain on the sale of the residence

Commentary:

- Tracking and reporting of foreign currency gain is unworkable for individuals whose entire financial life revolves around a foreign currency; a meager and non-indexed increase in the personal exemption limit is insufficient in this regard.
- Making foreign-currency losses deductible against capital gains on a house appears more beneficial to property investors rather than to middle-class citizens living abroad. It does little to address problems related to “phantom currency savings” on mortgages that occur when a currency decreases in value (simultaneously reducing any capital gain).
- There is significant double taxation that occurs in cases of misalignment between countries with a “stamp duty” (tax paid by the buyer at purchase) and the United States, where tax is paid by the seller at time of sale. Relief is also desperately needed in this area.

Our Recommendations:

- Individuals residing outside the United States should be exempted from taxation of foreign-currency gains related to the currency of the country in which they reside
- Exemption of primary residence and mortgage on primary residence from Foreign Exchange Gain/Loss: Capital-gain calculations should permit the use of an exchange rate based on the day the house was purchased, eliminating phantom currency gains & losses.

Provide for Information Reporting by Certain Financial Institutions and Digital Asset Brokers for Purposes of Exchange of Information

Major Changes:

- U.S. financial institutions would require FATCA account reporting at U.S. financial institutions for any “foreign persons.”

Commentary:

- We urge caution when implementing this proposal, noting the severe financial-access issues caused by FATCA and the reliance of overseas Americans on U.S. financial institutions (due to FATCA and anti-offshoring provisions of the Internal Revenue Code).
- If FATCA’s scope of reporting is expanded to U.S. banks, it is both timely and necessary to address financial-access issues stemming from this reporting requirement.
- When FATCA was implemented in Europe, Americans abroad were locked out from banking - unable to open or maintain a bank account in their country of residence and faced with difficulty opening or maintaining a bank account in the U.S. Without financial access protections, our concern is that a similar wave of account closures and refusals could occur in the US.

Our Recommendations:

- To protect U.S. Citizens’ access to U.S. services, all U.S. Tax Residents must have equal access to financial services and products; a foreign address cannot be valid grounds for refusal or reduction in services.
- To protect U.S. Citizens’ access to financial services in the countries in which they live; being a U.S. Citizen or U.S. Tax Resident cannot be valid grounds for refusal or reduction in services.

Conclusion

Our recommendations are in response to the changes proposed by the Treasury in the 2023 “Green Book” and would be aligned with any legislative changes made in response to those proposals.

We strongly believe that more fundamental reforms are also necessary to address the underlying issues facing Americans abroad, namely:

1. Double taxation — due to misalignment of tax systems — that cannot be mitigated using the Foreign Earned Income Exclusion (FEIE), Foreign Tax Credit (FTC), or existing Tax Treaties.
2. Disproportionately high tax-preparation costs and excessive compliance risks associated with information-reporting required for financial assets held in a U.S.

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citizen's country of residence, which harms ordinary Americans who are unable to afford sophisticated tax preparers, which (as noted) can be prohibitively expensive even if no tax is owed.

3. Excessively large and regressive penalties related to information reporting errors that far exceed taxes owed or balances of accounts concerned and individuals' ability to pay.
4. Americans abroad with a non-U.S. citizen spouse facing discriminatory treatment in the tax code and greater difficulty in meeting filing obligations due to the lack of a Social Security Number for their spouse.
5. Corporate tax rules intended to apply to overseas subsidiaries of multinational corporations that are applied to small businesses owned by Americans residing abroad, resulting in unreasonably high compliance costs and punitive taxation of undistributed income.
6. A lack of access to necessary financial products and services caused by a mix of burdensome reporting obligations and punitive treatment of local products in the US tax code.

Americans residing abroad have been effectively barred from saving for retirement, starting a small business, taking title to real estate, or sharing finances with their spouse. The devastating consequences result in inability to retire, forced closure of small businesses, divorce from non-American spouses, and even suicide. This is on top of the inordinate stress, cost, and time involved just in understanding and meeting the complex reporting requirements of the U.S. tax code.

The current IRS definition of "tax residency" includes the obligation to report worldwide income (including non-U.S. source income), even of Americans who are tax residents of other countries. This requires the IRS to do the impossible: to administer both a domestic tax system for U.S. residents (including source taxation for non-resident aliens) and also an extraterritorial system interacting uniquely with the tax codes of other countries.

Administering this extraterritorial tax system has become an overwhelming task, both procedurally and substantively. The IRS cannot remotely serve Americans in the more than 100 foreign countries where they live, let alone in the languages they speak. Nor can the IRS know how U.S. laws apply to the local financial services, small business structures, and retirement savings plans that are common in those countries.

The IRS itself has identified “international taxpayers” as an underserved community.³ The level of service currently provided by the IRS to Americans inside and outside the country is highly unequal. For those abroad, IRS agents are insufficiently trained to respond to the common issues faced.

Americans abroad have pleaded for relief for over a decade, with no meaningful response from Congress or the Treasury Department. **It is time for Congress to cease the imposition of filing requirements for the non-U.S. source income of non-residents.**

Cost/benefit analysis of such a transition from citizenship-based to residence-based taxation should include consideration of what would be required for the IRS to provide fair and equitable support to non-resident filers under the current system. We believe that transitioning to residence-based taxation would:

- Substantially improve the well-being of Americans abroad;
- Improve the administrability of the Internal Revenue Code and facilitate greater tax compliance;
- Reduce strain on an Internal Revenue Service that has expressed that the burden associated with servicing Americans abroad is disproportionate to the miniscule tax revenue raised.

We plan to release updated research on Americans abroad and their tax situations this summer. We will share our results and analysis with the Committee and encourage you to review it then.

Thank you for the opportunity to provide this testimony.

Please do not hesitate to contact Rebecca Lammers of our Taxation Task Force on taxadvocacy@democratsabroad.org with any questions about the information and recommendations provided.

Sincerely,

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³ IRS. (2021, January). Taxpayer First Act Report to Congress. Retrieved April 5, 2022, from [https://www.irs.gov/pub/irs-pdf/p5426.pdf?mc_cid=95523e3176&mc_eid=\[942e2d2064\]](https://www.irs.gov/pub/irs-pdf/p5426.pdf?mc_cid=95523e3176&mc_eid=[942e2d2064])

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