April 1, 2013

House Ways and Means Committee
Attn: International Tax Reform Working Group

Dear Representatives Nunes and Blumenaur,

As a private citizen residing permanently overseas, I would like to take this opportunity to ask the International Tax Reform Working Group (ITRWG) to consider adopting a system of residence-based taxation (RBT) for those U.S. citizens who permanently reside in foreign countries. This would eliminate the unfairness of citizen-based taxation (CBT) imposed on overseas residents and bring the United States in line with other OECD countries.

However I strongly disagree with other proposals that have already been presented to the ITRWG that suggest (for implementing RBT) that U.S. citizens overseas be taxed in the same manner as non-resident aliens. One such proposal was submitted and publicized by the American Citizens Abroad (ACA) group based in Geneva and will be referred to later as the "ACA Proposal".

BACKGROUND

It is a well known fact that the United States is the only modern and industrialized nation that taxes its citizens on income earned in other nations regardless of residency. This citizen based taxation (CBT) is unfair to residents who reside overseas on a permanent basis and currently manifests itself as a three-tiered problem.

The lower tier focuses on the fundamental issue of taxing overseas citizens. To date there has been a wealth of discussions and studies on this subject and they will not be repeated here. It will be enough to say that the United States and its CBT policy forces citizens overseas to incur tax liabilities on foreign income that really has nothing to do with the United States. As seen by most, it's not right and it's not fair and the United States is simply overstepping its jurisdiction. With regards to double taxation, U.S. citizens are not well protected and are denied any tax treaty benefits due to the "saving clause" inserted in practically all treaties with other countries. It is not surprising that more and more Americans are giving up their U.S. passports.

The second tier is the additional taxation that was brought about by 'stacking rules' in the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). TIPRA uses excluded income to place the taxpayer with U.S. source income in a higher tax bracket. In the Webster dictionary, the term ***exclude*** means "to not consider or have an effect" however it appears Congress does not use the same English language dictionary and excluded income is considered when it comes to taxes.

Lastly the upper tier centers on the existing unfair IRS formulas for calculating additional tax liability with foreign income due to the wording in the TIPRA legislation. I brought this matter to the attention of the IRS who responded as follows:

[QUOTE]
"The Foreign Earned Income Tax Worksheet in the Form 1040 instructions is intended to figure the tax on the non-excluded income at the higher rate that would have applied if no income had been excluded.

To this end, the worksheet provides a 3-step calculation:

A. Figure the tax on all your income as if no exclusion was allowed (lines 1 through 4 of the worksheet; section 911(f)(1)(A)(i) of the Internal Revenue Code),

B. Figure the tax on the excluded income only (line 5 of the worksheet; section 911(f)(1)(A)(ii) of the Internal Revenue Code), and

C. Subtract B from A (line 6 of the worksheet; section 911(f)(1)(A) of the Internal Revenue Code).

Any change in this computation would require legislative action by Congress.

I hope this information is helpful.

Karl Blake
Tax Law Specialist (Reviewer)
Tax Forms and Publications Division"
[END QUOTE]

The real problem here is in Step B. The tax on the excluded income is not a proportional amount of the total tax as it should be. For example if the total income was $190,200 and the excludable amount is $95,100, then 50% of the total tax liability is attributable to the excluded amount. However, by IRS rules the amount of tax attributable to excluded income is simply looked up in the tax table as though it was the only income, hence in Step C above there is a smaller amount to subtract from the total. In all other IRS calculations, such as those found on Forms 1116 (Foreign Tax Credit) and 2555 (Foreign Income), proportional amounts are used. This is the only fair way to do these types of foreign income vs. total income calculations.

The IRS rules are based on the actual wording of TIPRA, more specifically P.L. 109-222, Section 515 (f)(1)(B) which states " the tax which would be imposed by section 1 for the taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for the taxable year". The same text is used in the AMT section (2)(B).

Both sections should be modified to read "the pro rata share of the tax which would be imposed by section 1 for the taxable year that is attributable to the amount excluded under subsection (a) for the taxable year."

PERSONAL EXPERIENCE AS AN OVERSEAS TAXPAYER

I live permanently in Spain (due to family ties) and have been a permanent resident here for 20 years. It was not until 2009 that I really became aware of the tax implications that go along with being a U.S. citizen. That year I filed amended tax returns for 2007 and 2008 after finding out that my income from foreign employment was also subject to taxes in the United States even though I had already paid taxes to the host country. The real surprise came when I found out that the taxes increased on my military retirement pension by almost $1000 per year even though all of my foreign income was excludable (and way under the limit!). Naturally one must ask "Why should a military pension (or any other pension) be taxed at a higher rate just because of foreign income which is 100% excludable?" It is a known fact that TIPRA has imposed a burden on the many thousands of military retirees who live overseas, especially those in Europe. The ACA Proposal would make things even worse by imposing a flat 30% withholding on pensions. Therefore I strongly recommend that the ITRWG <u>not consider</u> the ACA Proposal which in my estimation appears to be nothing more than a "whitewash" for a select few with large overseas fortunes and certainly does nothing for the many tens of thousands of military retirees overseas.

<u>RECOMMENDATIONS</u>

Before presenting my recommendations below, I would like to state that switching to RBT from CBT should not be a "give-and-take" situation as in the ACA Proposal. CBT is wrong and RBT is right and the American way has always been to "make things right". We don't rob Peter to pay Paul. The current funding situation in Washington is not an excuse to continue the "legal thievery" from honest and hard working American citizens overseas who happen to be permanent residents in another country. We need to change the tax code in such a way that it keeps Americans abroad and makes the United States more visible and competitive in the global arena.

I recommend the ITRWG consider the following recommendations:

1. Change to a residence-based tax system instead of a citizen-based tax system. Any and all income earned by U.S. citizens abroad from foreign sources should not be taxed by the United States if the citizen is a permanent resident of another country and subject to that country's tax laws. Naturally, income from U.S. sources would continue to be taxed by the United States but should <u>NOT</u> be subject to higher tax rates due to non U.S. source income, i.e. by using any stacking rules. The change to RBT would imply the elimination of the "saving clause" from new and existing tax treaties.

2. Should it not be possible to switch to a residence-based tax system immediately, the existing Foreign Earned Income Exclusion (FEIE) should be changed to an unlimited amount for those citizens with permanent residence in a foreign country. The exclusion should include all passive income as well as all earned income and should be appropriately renamed as the "Foreign Income Exclusion". The stacking provisions of TIPRA should be eliminated so that foreign income is not taken into account when determining the taxpayer's U.S. tax liability.

3. Should the recommendations above not be possible in the near future, as a bare minimum TIPRA should be changed in order to correct the unfair calculations on the Foreign Earned Income Tax Worksheet in the Form 1040 instructions. More specifically, P.L. 109-222, Section 515 (f)(1)(B) which states " the tax which would be imposed by section 1 for the

taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for the taxable year" should be changed to read "the pro rata share of the tax which would be imposed by section 1 for the taxable year that is attributable to the amount excluded under subsection (a) for the taxable year."

In conclusion, I hope the ITRWG will take into consideration the information above.

Sincerely,

LCDR James R. Albright, USN (retired)