| ACA | AARO | FAWCO |
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| American Citizens Abroad | Association of Americans | Federation of American |
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The Honorable David Camp, Chairman
The Honorable Sander M. Levin, Ranking Member
U.S. House of Representatives Ways and Means Committee

January 31, 2011

## Testimony to the Ways and Means Committee Hearings on Fundamental Tax Reform

Dear Chairman Camp and Congressman Levin,

American Citizens Abroad (ACA), the Association of Americans Resident Overseas (AARO) and the Federation of American Women's Clubs, Inc. (FAWCO) are non-profit, non-partisan associations representing the interests of American citizens residing and working abroad. With more than 20,000 members in over 90 countries, including an umbrella network linking over 75 independent American, international volunteer organizations in 39 countries and a vast information network reaching out to the American community abroad, our organizations are a forceful voice for overseas Americans. We appreciate the opportunity to submit written testimony, as requested by the First Ways and Means Hearing of the 112th Congress to *Examine the Burdens Imposed by the Current Federal Income Tax System and the Need for Reform*.

## EXECUTIVE SUMMARY

**In order to promote exports, simplify taxation and acknowledge the global nature of the world economy, overseas Americans recommend that Congress abandon citizenship-based taxation and tax both the self-employed and employed exclusively on the basis of their residence in the United States, as is the general policy in other nations.**

- **The United States is the only country in the world imposing citizenship-based taxation.**[1] In theory, citizenship-based taxation means that all Americans, irrespective of their domicile, within or outside the borders of the United States, shall pay the same U.S. taxes. It is an anomaly in today's global economy. In practice, citizenship-based taxation means that Americans resident overseas pay taxes in both their country of residence and in the U.S., the latter however under deduction of the Foreign Earned Income Exclusion and of credits for the taxes paid abroad. This has numerous undesirable side effects.
- **Negative impact of citizenship-based taxation on U.S. competitiveness:** Most U.S. corporations severely restrict deployment of Americans abroad because of the prohibitive tax burden borne by the employer to provide a U.S. citizen with equal take-home-pay. International work experience for U.S. citizens is a vital component to an active U.S.A.

[1] Eritrea is possibly the only other country to apply citizenship-based taxation.

- **The current situation restrains employment opportunities for U.S. citizens:** For all other overseas Americans, i.e. those without a so called "expat package", citizenship-based taxation means either standards of living lower than those of their U.S. counterparts with similar circumstances, or lower than their counterparts in their country of residence. At a time of high unemployment in the U.S., it is not in the interest of the country, the U.S. government or U.S. citizens to artificially limit employment opportunities overseas. Actually, overseas employment relieves the fiscal burden of high unemployment, as well as provides a competitive edge for future exports.
- **U.S. citizens abroad are valuable to the United States as unpaid private sector diplomats:** U.S. citizens abroad are much more likely to mingle and interact on a daily basis with foreign nationals than many U.S. government employees and thus provide the U.S. with a valuable uncompensated public relations service as private sector diplomats.
- **Benefits argument:** U.S. citizens residing abroad do not receive, by a wide margin, anywhere near the same level of benefits as those residing in the United States. Indeed, many receive no benefits at all from the U.S. government.
- **Ability to pay:** U.S. citizens residing abroad pay taxes to the country of residence, often paying higher total taxes than Americans residing in the United States with comparable income or non-U.S. citizens in similar circumstances in their country of residence.
- **Administrative burden:** The administrative burden and cost to the tax payer and the IRS is out of proportion with the tax revenue collected by the IRS from such taxpayers.
- **Citizenship-based taxation leads to unfair taxation and double taxation:** Most Americans residing abroad pay higher total taxes abroad and yet still owe U.S. taxes. Incompatibilities between tax systems of different countries and specific discriminations in the U.S. tax code always work in disfavor of Americans resident abroad.[2]
- **Citizenship-based taxation is encouraging U.S. citizens to expatriate:** Instead of focusing on making expatriation more difficult or expensive, Congress should adopt residence-based taxation to reduce the increasing number of U.S. citizens that are abandoning their U.S. citizenship and severing all ties with the U.S. due to tax burdens.[3]

## Compensating tax measures if residence-based taxation is adopted

- If residence-based taxation is adopted, bona fide overseas American residents should be taxed in the same manner as nonresident aliens. Most U.S. source income paid to citizens abroad should be subject to U.S. withholding tax at the standard withholding or applicable treaty rate. As a corollary, the new law should supersede the "savings clause" written in the current tax treaties which excludes U.S. citizens from treaty benefits. Taxing capital gains on the disposition of U.S. real estate would be maintained in accordance with general international tax practice.
- Today the U.S. does not withhold taxes on the interest earned on U.S. bank deposits held by individual foreigners. Congress may consider initiating a withholding tax on individual bank deposits held in the United States by foreigners and nonresident Americans.

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[2] Annex 1 lists the most obvious discriminations in the U.S. tax code against Americans resident abroad.

[3] Bryan Knowlton, "More American Expatriates Give up Citizenship", New York Times/IHT, April 25, 2010 - http://www.nytimes.com/2010/04/26/us/26expat.html?_r=1&src=me&ref=general ; Martin Vaughan, "More Americans Sever U.S. Ties as IRS Gets Tougher", Wall Street Journal, April 5, 2010 - http://online.wsj.com/article/SB10001424052702304017404575166211517964090.html?m; Helena Bachman, "Why More U.S. Expatriates are Turning in their Passports", TIME Magazine, April 20, 2010 - http://www.time.com/time/world/article/0,8599,1983238,00.html?xid=rss-topstories

**Recommended minimum tax reforms applicable to U.S. citizens who are bona fide residents abroad if residence-based taxation is not adopted by Congress**

- Eliminate the cap on the foreign earned income exclusion in recognition of differing living standards around the world, as was the case prior to 1962.
- Allow foreign net asset taxes to be creditable against U.S. taxes.
- Recognize VAT as a consumption tax that is equivalent to U.S. sales taxes.
- Allow use of a non-U.S. dollar functional currency for calculating capital gains, as is the case with corporations.
- Recognize foreign pensions not as passive income but as foreign earned income subject to foreign earned income exclusion. Alternatively, allow foreign pensions to be taxed only in the country of residence.
- Exempt American citizens who are bona fide overseas residents from the requirement to file the new FATCA Form 8938 with their 1040 in addition to the FBAR filing.
- Eliminate the requirement in the FBAR filing to report on foreign bank accounts where the American citizen has only signatory authority, but no financial interest.

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## RECOMMENDATION THAT CONGRESS ABANDON CITIZENSHIP-BASED TAXATION AND TAX INDIVIDUALS' WORLDWIDE INCOME EXCLUSIVELY ON THE BASIS OF THEIR U.S. RESIDENCE

### Competitiveness argument

Citizenship-based taxation restricts the free movement of Americans abroad and is based on the false premise that such individuals compete with other U.S. citizen residents for employment or business opportunities. The playing field of overseas Americans is with foreign nationals and foreign businesses, not U.S. residents. In today's global economy where more Americans should be working to promote American business and exports abroad, the number of Americans working for American corporations abroad is very limited and has been sharply cut back due in large part to the unique U.S. tax burden.[4] Compared with other OECD countries, the United States has a very small proportion of its citizens residing abroad.[5] China is known to use its vast international network of Chinese citizens working throughout the world to promote its exports. Restricting job opportunities for Americans abroad leads to insufficient international experience among American managers and also eliminates a fiscal safety valve for the U.S. during periods of high domestic unemployment. With the United States aiming to double its exports in five years, it is essential that Americans obtain overseas experience.

**A foreigner representing a foreign company can reside in the United States and pay only U.S. taxes. Any U.S. citizen representing a U.S. company in a foreign country is subject to the taxes of both the country of residence and the United States. Herein rests a unique competitive disadvantage that the United States has created for itself.**

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[4] "U.S. Employees Overseas at U.S Multinational Corporations Update", prepared by Andy Sundberg, January 2011, based on Department of Commerce data.
http://www.aca.ch/joomla/images/pdfs/usemploy.htm

[5] Report prepared by American Citizens Abroad based on OECD Data Base on Immigrants and Expatriates, from the OECD Report on Trends in International Migration and Migration Policies, January 2005.
http://www.aca.ch/joomla/images/pdfs/diaspora.htm

Congress wants jobs, economic sustainability and increased exports. All of these are impossible as long as the U.S. maintains its citizenship-based tax system and hinders competitiveness. There are 155 million in the workforce in the U.S.A. producing a GDP of roughly $15 trillion. Hence each job's average contribution to the GDP is roughly $95,000. The U.S. current trade deficit of $600 billion equals more than 6 million lost jobs. That $600 billion also represents lost tax revenue to the Treasury. At the average tax share in the GDP of 18%, U.S. taxes forgone amount to $108 billion. Maintaining citizenship-based taxation, which brings in limited tax revenue, is actually costing the Treasury through lost trade. Increasing tax pressure on Americans abroad initiated in the late 1970s coincided with the beginning of the U.S. chronic trade deficits that have accumulated a foreign debt exceeding $7.7 trillion. When we cannot compete via American presence in foreign markets, we lose sales, markets, domestic jobs and revenue to the Treasury.

**Government and professional studies have systematically concluded that eliminating America's citizenship-based tax burden would increase exports.**

A 2005 report by PricewaterhouseCoopers, entitled "Economic Analysis of the Foreign Earned Income Exclusion"[6], concluded: "Section 911 is a provision of the U.S. tax code designed to offset the competitive disadvantage U.S. taxpayers face working abroad. Repeal of Section 911 is estimated to reduce the number of Americans working abroad, causing an $8.1 billion loss in U.S. manufactured exports that support 77,115 U.S. domestic jobs. By contrast, removing the $80,000 cap on the foreign earned income exclusion is estimated to increase U.S. manufactured exports by $14.4 billion supporting 137,319 U.S. domestic jobs." The cap adjusted for inflation since 2006 is $91,500 in 2010.

Following the debacle of the U.S. Tax Reform Act of 1976 when the foreign earned income tax exclusion was eliminated and tens of thousands of Americans were forced to return to the United States, the GAO and the President's Council studied the relationship between U.S. exports and American citizens working abroad.[7] All studies concluded that U.S. tax policies on American citizens abroad negatively impacted U.S. exports and reduced U.S. employment. They concluded that it is essential to maintain a large force of U.S. citizens abroad to promote and service U.S. products and operations. They recommended the adoption of tax policies comparable to those of all other industrial nations, none of which taxes citizens who meet overseas residency criteria.

Developing a true export policy, which aims to generate domestic jobs, will undoubtedly require a multifaceted approach on broad fronts. Tax policy is one of the key issues. Tax reform for U.S. corporations as recommended by the President's Tax Reform Panel is certainly an important step. However, exports are realized through efforts of teams of people and the United States needs more American feet on the ground around the world to represent U.S. business interests, whether corporate or non-corporate. This requires fundamental reform of U.S. tax policy towards American citizens working and residing abroad, such as eliminating citizenship-based taxation, to allow Americans to compete abroad on a level playing field with their foreign country competitors. Today, the tax laws discourage American companies from employing American staff in their overseas operations and discourage American citizens from accepting overseas posts with foreign employers on their own. U.S. tax reporting policies with respect to foreign business interests discourages small- and medium-sized companies from setting up sales operations abroad and seriously penalizes the American entrepreneur working and residing abroad.

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[6] Pricewaterhouse Coopers, *Economic Analysis of the Foreign Earned Income Exclusion*, prepared for The U.S. Chamber of Commerce, The American Business Council of the Gulf Countries (ABCGC), and the Asian Pacific Council of American Chambers of Commerce (APCAC), November 7, 2005.

[7] GAO, February 21, 1978, *The Impact on Trade of Changes in Taxation of U.S. Citizens Employed Abroad*; President's Export Council, December 10, 1979, *Task Force to Study the Tax Treatment of Americans Working Overseas*; GAO, ID-81-29, *American Employment Abroad Discouraged by U.S. Income Tax Laws*.

**U.S. citizens residing abroad represent a vital asset for the United States:** The informal ambassador role that American citizens inevitably exercise when they reside abroad represents an immense free resource for the United States, not only through the goodwill created in schools, communities and businesses but also through the contacts and information acquired by these citizens that are beneficial in the long-term to the United States in terms of security, technological research and business developments.

**Benefits argument:** U.S. citizens residing abroad do not receive the same benefits, if any at all, as those residing in the United States, since they do not use U.S. infrastructure and cannot claim Medicare benefits abroad. The often cited benefit of U.S. consular services is now significantly financed by user fees. In fact, the U.S. consular service is a profit center for the U.S. government and provides services almost exclusively to non-U.S. citizens and to U.S. citizen tourists and business travelers. For most Americans residing abroad, the sole tangible benefit derived from U.S. citizenship is the right to carry a U.S. passport (once again, for a fee in addition to any taxes paid.) Other countries do not tax their citizens for the right to hold a passport. Overseas Americans pay taxes in their countries of residence because they obtain benefits there, such as roads, schools, health services, social security, court systems, law and order, etc.

**Ability to pay argument:** Since the United States recognizes that the country of residence has first right to tax U.S. citizens abroad, the amount of revenue collected by the United States is the marginal difference due to either higher tax rates in the United States or incompatibilities between tax definitions of the United States and foreign countries. A third of the Americans abroad who file Form 2555 owe no U.S. taxes and those that do pay U.S. taxes do so based on differences in marginal tax rates and tax definitions. Since foreign governments claim the bulk of tax revenue, the U.S. in effect has secondary taxing jurisdiction and limited claims. Certain overseas Americans pay higher total taxes abroad than the U.S. domestic equivalent for their income level and yet may still owe taxes to the United States due to differing types of taxes.

**Administrative burden argument:** The administrative burden for the taxpayer and the IRS is out of proportion with the tax revenue generated. Compliance for Americans residing abroad is much more complicated than for U.S. residents due to foreign exchange calculations and the need to file Forms 2555 and 1116 for individuals or even Form 8621[8] for those who own foreign mutual funds. Calculating tax credits on Form 1116 is so complicated that nearly all Americans abroad must hire a highly qualified professional tax preparer. For those who run foreign businesses, Forms 5471, 8865 and/or 8858 are a nightmare. Form 5471 alone is described by professional tax preparers as an administrative horror; the IRS estimates 80 hours to complete this one form. The cost of professional tax preparer services already easily exceeds $2,000 per year for the simplest personal returns and can reach in the tens of thousands of dollars for those who operate businesses abroad. Moreover, the recent FATCA legislation[9] will henceforth require anyone with foreign financial assets exceeding $50,000 to report those assets on a new Form 8938, in addition to the current FBAR filing on financial assets, rendering compliance even more costly and burdensome. This compliance burden adds to the requirement for Americans overseas to file tax returns in the country of residence as well as in the U.S.

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[8] The IRS time required estimates for Form 8621 are 8.5 hours to learn the law and the form, 13.5 hours for record keeping and 9.25 hours for preparing the form.

[9] Foreign Account Tax Compliance Act, included in the HIRE Act passed in March 2010. FATCA aims to track down U.S. citizens evading taxes by hiding assets overseas, essentially Americans residing in the United States. The same organizations undersigned here addressed detailed comments on the difficulties involved with filing form 8938 to the IRS in a letter dated December 17, 2010 requested by Treasury.

**Fairness argument:** Citizenship-based taxation is fundamentally unfair as most U.S. citizens abroad already pay higher total taxes abroad than a person in a comparable economic situation in the United States, receive few direct benefits from the U.S. and yet can still owe U.S. taxes.

First, incompatibilities between U.S. and foreign tax law systematically penalize and lead to double taxation, despite mitigating measures in Section 911 and application of foreign tax credits.

Second, the U.S. tax code specifically discriminates against U.S. citizens residing abroad. Some of the more blatant examples of discrimination are listed in Annex 1 at the end of this document.

Third, citizenship-based taxation has become a tax on those willing and/or knowledgeable, i.e. a tax on those American citizens residing abroad who are aware of and willing to file tax returns annually with the IRS. When the U.S. government reaches beyond its territory to tax citizens, it does not have the same administrative authority over enforcement that it has in the U.S., nor does it provide the same level of outreach or support to its taxpaying citizens. Hence, not all American citizens residing abroad file with the IRS, essentially either through ignorance of the law or because they think the paperwork useless since they would in any case owe no taxes to the U.S. government. Those who do file therefore carry an exceptional administrative and fiscal burden. A tax on those willing to pay certainly does not meet recognized criteria for fair and equitable taxation. As stated by Professor Avi-Yonah, "*A law that cannot be enforced is a bad law*."[10]

Fourth, due to the growing complexities of U.S. tax compliance and consequent severe restraints on their professional and work-related activities abroad, an increasing number of Americans overseas are renouncing their U.S. citizenship and severing all ties with the United States despite the cumbersome procedure, potentially high expatriation tax cost put in place under IRC 877A and the personal sacrifices this entails for most individuals. Americans married to foreigners now hesitate to register their children born abroad for U.S. citizenship because of the life-time tax implications. Laws that cause individuals to feel it is necessary to sever all ties with the United States are ultimately not in the best long-term interests of the country. Such laws constrain U.S. export growth. The solution to these expatriations is not to make expatriation more difficult, but rather to change the U.S. tax system to a system that taxes based on residence.

This trend is particularly disturbing as we know of many instances where our own children who have been brought up and educated abroad have returned to the United States to pursue their studies and carry out extremely productive careers which create U.S. jobs and lead to technological leadership in the United States. Cutting off this source of contributing U.S. citizens is counterproductive and shortsighted.

Equally disturbing, those who have not been compliant (either unintentionally or intentionally) are now becoming aware of the risks of their illegal position due to the publicity of the recent aggressive policies of the IRS abroad. They are faced with the prospect of paying the price to admit their failures to the IRS and suffer a highly punitive tax of 20% or more on their financial assets for not having filed the FBAR, even if they never owed income taxes to the United States, or to try to fade out of sight of the IRS and never return to the United States.

At the same time that the United States encourages educated foreigners to immigrate into the country to fulfill the needs of industry, the nation pushes away its own citizens residing abroad for reasons of administrative tax compliance. It is absurd and self-defeating, particularly since the population of Americans overseas has the international experience and foreign language mastery that is so needed by the United States in today's global market, as well as innate high loyalty to

[10] Professor Reuven S. Avi-Yonah, "The Case Against Taxing Citizens", Working paper No 190, March 2010, p. 10. – http://www.law.umich.edu/centersand programs/elsc/abstracts/pages/papers.aspx.

the country. This negative impact for the United States cannot be overstated. **If the U.S. were to give up its citizenship-based tax policy, it would significantly enhance its competitiveness by allowing free movement of its citizens in the world, to acquire international experience and to reinforce America's presence in the world.** As Professor Avi-Yonah stated, "In a globalized world, citizenship-based taxation is an anachronism which should be abandoned."[11]

## COMPENSATING TAX MEASURES WITH RESIDENCE-BASED TAXATION

The amount of U.S. taxes paid by all citizens residing overseas is not known to us as the published IRS data does not separate those residing abroad from those residing in the U.S. for citizens who file Form 1116. The vast majority reside in the United States. However, in 2006 (the latest year for which data is publicly available), the U.S. income taxes paid by Americans filing Form 2555 to claim the Foreign Earned Income Exclusion amounted to $5 billion.

Eliminating citizenship-based taxation does not mean that U.S. citizens would stop paying U.S. taxes altogether. We recommend certain modifications in the tax law that could significantly reduce, or even eliminate altogether, any short-term revenue gap.

**First, we recommend that in conjunction with the elimination of citizenship-based taxation, non-resident U.S. citizens be taxed in the same way as non-resident aliens.** For example, U.S securities held by Swiss taxpayers are subject to a 30% U.S. withholding tax, half of which can be reclaimed under the terms of the U.S.-Swiss tax treaty. In the absence of citizenship-based taxation, the same would apply to U.S. citizens residing in Switzerland who owns U.S. securities. The system is already in place and brings money into the U.S. Treasury.

To ensure that the United States receives taxes due from U.S. citizens residing abroad on U.S. source income, the U.S. would logically impose a withholding tax at the applicable treaty rate on the following categories of U.S. sourced income:

- Portfolio income, i.e. interest and dividends paid by U.S. companies: Americans residing abroad would be taxed as are foreign investors today under tax treaties.
- U.S. Social Security payments destined to U.S. citizens resident abroad
- U.S. pension or insurance annuities paid to U.S. citizens resident abroad
- Employment-related income earned from a source based in the United States
- Income attributable to the conduct of a U.S. trade or business
- U.S. sourced royalty payments
- Rental income on U.S. real estate
- Capital gains on the disposal of U.S. real estate.

American citizens residing abroad in countries which tax on worldwide income would apply the U.S. withholding taxes as credits against the taxes due in their country of residence, in accordance with bi-lateral tax treaties and tax laws of the resident country. American citizens residing in tax-haven countries would de facto pay the withholding tax to the United States with no recourse.

**Second, the United States may initiate a withholding tax on U.S. bank interest payments made on bank deposits held in the United States non-resident foreigners.** In light of the above proposal, American citizens with a bona fide residence abroad would also be subject to that withholding tax on personal bank deposits held in the United States. The fact that today the United States does not tax the interest on U.S. bank deposits held by non-resident foreigners makes the United States a tax haven. Changing that policy would provide significant tax revenue for the United States.

[11] Professor Reuven S. Avi-Yonah, Ibid., p. 2.

**It is possible, and even probable, that with these changes eliminating citizenship-based taxation would be tax revenue neutral for the United States.** Retirees with largely U.S. source retirement income but resident in a country with low-taxes, may pay more taxes to the United States through the withholding taxes mentioned above than they do under the current system. Withholding taxes on foreign bank deposits in the United States would bring in significant new revenue to the U.S. Treasury.

**Finally**, it is important to emphasize that increased participation of U.S. citizens in foreign trade should bring about significant growth for the U.S. economy, compensating many times over any short-term loss of tax revenue from citizens residing abroad. Every $1 billion of additional exports, according to Secretary of Commerce Gary Locke, would create 6,250 direct manufacturing jobs and a substantial additional number of indirect jobs. It would also raise approximately $180 million dollars in domestic tax revenue. Just $30 billion of additional exports due to policy changes would compensate for potential tax revenue loss from the elimination of citizenship-based taxation and create 187,500 new manufacturing jobs.

**We highly recommend that the Ways and Means Committee request the GAO to include in its studies on the tax revenue implications of Fundamental Tax Reform the net tax revenue impact of eliminating citizenship-based taxation combined with the treatment of bona fide overseas residents comparable to non-resident aliens and the initiation of taxation of U.S. bank deposits held by foreigners and non-resident citizens as well as the expected increase in U.S. exports from the new tax treatment of Americans abroad.**

## MINIMUM TAX REFORMS NECESSARY IF CONGRESS DECIDES NOT TO ELIMINATE CITIZENSHIP-BASED TAXATION.

In absence of fundamental reform eliminating citizenship-based taxation, there are urgent measures which Congress should enact to allow Americans to be competitive working abroad and to attenuate the unfair double taxation and serious administrative burden presently on the shoulders of Americans residing abroad.

**Eliminate the cap on the Foreign Earned Income Exclusion,** as was the case before 1962. Although the foreign earned income exclusion (Section 911 of the Tax Code) is listed among “tax expenditures”, the terminology is incorrect in this specific case. The anomaly is not the exclusion as such, but the fact that the United States taxes its citizens residing abroad. The foreign earned income exclusion was introduced to mitigate the negative affects of citizenship-based taxation on the competitiveness of Americans abroad. Eliminating the cap on the foreign earned income exclusion would not eliminate the double reporting burden, but it would allow more Americans to compete for jobs abroad. It would recognize that salaries abroad take into account foreign cost of living expectations, which vary widely, rather than U.S. cost of living expectations.

**Allow foreign net-worth taxes to be creditable against U.S. taxes.** In some countries net-asset taxes replace capital gains taxes. These taxes can be substantial, almost 1% per year of total assets or more in many countries, often exceeding U.S. income taxes. If the foreign asset taxes are not creditable, as is the case currently, there truly is double taxation.

**Allow individual taxpayers residing abroad and operating in a non-U.S. dollar environment to calculate capital gains in the currency of their country of residence, i.e. using that currency as a non-U.S. dollar functional currency.** This should apply to all foreign-held assets but at a minimum to their primary residence and bank financing linked to that residence. Under a functional currency, the gain on any asset sale would be calculated in local currency and translated into U.S. dollars at the exchange rate applicable on the sale date. Currently, the foreign purchase and sale price must be calculated in U.S. dollars at the exchange rates applicable on the respective dates of purchase and sale. Since the dollar has lost value against foreign currencies, U.S. citizens who buy and sell a home abroad or other foreign assets at the same local currency price face a very real capital gains tax in the U.S. on a fictitious gain in their own functional currency. This is terribly penalizing and violates a basic tenet of tax policy that taxes be based on an ability to pay. Adding to this punitive treatment, mortgages on real estate are treated as separate transactions. Foreign exchange losses on a mortgage cannot be deducted from the gain on the related property. But foreign exchange gains on mortgages, or any debt instrument, are taxable by the U.S. even when there has been no true monetary gain for the debtor. The use of a foreign functional currency is already allowed for U.S. business operations abroad. The option to use a functional currency should be extended to American citizens residing abroad.

**Permit foreign pensions to be treated as foreign earned income.** In general, contributions by the employee to U.S. pension funds are deductible and contributions by the employer are not taxable. But foreign pension contributions by the employee are not deductible and contributions of the foreign employer must be added to the gross income of the U.S. taxpayer overseas. The U.S. then also taxes the foreign pension payments to retirees as passive income. This is clearly discriminatory to overseas Americans. The U.S. government has attempted to correct this discrimination in specific tax treaties with Canada, Great Britain and perhaps other countries to allow foreign pensions to be taxed only by the country of residence. If residence-based taxation is not generalized for all foreign pensions, foreign pensions should be treated as foreign earned income, thereby allowing the foreign earned income exclusion to be applicable.

**Exempt Americans who are bona fide overseas residents from the requirement to file the new FATCA Form 8938 with their 1040.** This will greatly simplify filing for Americans abroad and will reduce the burden on the IRS for reports which are of doubtful value since the U.S. imposes taxes on income and not on assets. Americans residing abroad are already required to file the FBAR. Administrative jurisdiction for both of these forms should be integrated to eliminate duplicate filing requirements.

**Eliminate the FBAR filing requirement for foreign bank accounts where an American has signature authority but no financial interest.** This will open up job opportunities for Americans abroad. The current FBAR reporting requirement obligates the U.S. citizen whose employment responsibilities include payment and treasury functions for a foreign company to violate the confidence of that employer and foreign laws which consider revealing confidential employer information to third parties as a criminal offense.

**ENCOURAGE AMERICANS TO GO ABROAD TO PROMOTE U.S. EXPORTS**

Overseas Americans sincerely hope Congress will enact measures that allow U.S. citizens to be fully competitive with foreigners when working abroad to defend the interests of the U.S. economy. It is this dynamic, free movement of citizens which will strengthen the United States.

We thank you for your consideration.

Sincerely yours,


| ACA | AARO | FAWCO |
|---|---|---|
| American Citizens Abroad<br>The Voice of Americans Overseas | Association of Americans<br>Resident Overseas | Federation of American<br>Women's Clubs Overseas, Inc. |
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**Annex 1**

## Examples of U.S. tax code discrimination against U.S. citizens residing abroad

- In the absence of a tax treaty provision, contributions to foreign pension plans are not deductible on a US tax return. Contributions to US qualified pension plans, other than US Social Security and some IRAs, are deductible on the US return. Foreign social contributions for health, unemployment, etc. are added to the net salary income and declared by an American working abroad on the US tax return. The total of all contributions can exceed 20% of the salary. Americans employed in the US by US companies do not have this problem.
- Foreign taxes on net worth (which are in several countries a substitute for capital gains taxes) are not creditable against U.S. taxes; however, any capital gain realized is subject to U.S. capital gains tax.
- Most other countries raise a larger proportion of their tax revenue through VAT and other consumption taxes, which are also not creditable against U.S. taxes. This is a direct cause of double taxation. Citizens residing in the United States can deduct sales taxes on Schedule A whereas foreign VAT cannot be deducted.
- Education credits for students are applicable only if the university qualifies for U.S. government loans, which, in practice, requires attendance at U.S. universities.
- Energy saving credits for solar panels and hybrid cars are available only for a principal residence in the United States and for cars used in the United States.
- The 2010 Health Care legislation imposes a surtax on incomes in excess of $250,000 to finance Medicare benefits, yet Americans working and living abroad permanently will never benefit from Medicare.
- The IRS requires all reporting for U.S. tax purposes in U.S. dollars. With the U.S. dollar in steady decline over the past 40 years, reportable income is artificially inflated for U.S. citizens earning their incomes in foreign currencies.
- Fluctuations in the dollar cause taxes on fictive capital gains on foreign investments. If a U.S. citizen residing abroad sells any asset abroad without realizing any economic gain, he/she may still owe a capital gains tax in the United States if the dollar declined from the date of purchase. Furthermore, if that citizen had taken a mortgage in local currency to finance the house, repayment of the mortgage would lead to a nondeductible capital loss when translated into dollars. Yet a foreign exchange gain on a foreign debt repayment would be taxable, even if it resulted in no economic gain to the debtor.
- Arcane rules imposed by IRS, not SEC regulations, make reporting requirements prohibitive for foreign ETFs denominated in local currencies (total IRS time estimate is 31 hours), thus limiting foreign investment opportunities for Americans abroad.
- The recently passed Foreign Account Tax Compliance Act (FATCA) prejudices Americans abroad, as it requires individuals with foreign financial assets in excess of $50,000 to report those assets on a new Form 8938. Most living abroad will fall under this reporting requirement while few Americans in the United States will be affected. FATCA has turned Americans abroad into pariahs for the international banking system and many banks refuse to maintain investment accounts of Americans residing abroad unless they are wealthy and able to pay higher banking fees.
- FATCA also requires reporting to the IRS by any company or partnership in which an American citizen has 10% or more of the equity; this ruling shuts out Americans from business opportunities and entrepreneurial ventures overseas.