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To the International Tax Working Group, United States Senate Finance Committee

Thank you for inviting submissions on the important issue of the reform of international taxation. As a lecturer in United States Politics and International Political Economy, I have done considerable research into the evolution of the policy of citizenship-based taxation, the first results of which I will be presenting at the University of Michigan in October. I began my research after encountering several middle-class Americans living in England who had been very badly affected by U.S. tax policy. Unfortunately, such problems seem to be widespread: according to a survey conducted by University of Kent researcher Dr. Amanda Klekowski von Koppenfels, 31% of the Americans abroad she surveyed around the beginning of the year are considering giving up their citizenship because they find U.S. taxation policy towards individuals overly complex and punitive.

Of course, not all potential renunciants have strong ties to the U.S.. As legal scholar Peter Schuck has pointed out in another context, U.S. citizenship has become fairly easy to obtain and very difficult to lose. In both Mexico and Canada, the average U.S.-born individual moved away before they were 14. According to the 2006 Canadian Census, 42% of people with a U.S. birthplace, one of the key indica used for the Foreign Account Tax Compliance Act, considered themselves to be only Canadian. In light of this, the Obama administration's suggestion for relief for certain accidental dual citizens is a move in the right direction.

At the same time, the enforcement of citizenship-based taxation is causing some U.S. citizens with stronger connections to the country to renounce. Although the media focus on wealthy renunciants, Dr.Klekowski von Koppenfels' survey found that the poor and the middle class were about as likely to renounce. My comments will focus on three issues that seem to be particularly important for dissatisfaction among the non-wealthy: the increasingly burdensome nature of U.S. tax policy over time, the growing incompatibilities between U.S. taxation policy and foreign government social programs, and the difficulties in getting these problems addressed.

Why Citizenship-Based Taxation Has Become Increasingly Burdensome for the Non-Wealthy

A. Over Time The Focus of Policy Has Shifted to Less Wealthy Groups

The rhetoric surrounding taxing U.S. persons abroad has long been focussed on the wealthy, but the policy has affected increasingly less affluent people. When the U.S. embraced citizenship-based taxation in the 1860s and again in 1894 and 1913, many of the policy's most vehement supporters focussed their arguments mainly on wealthy Americans who were spending their U.S.-source inheritances in Europe because they preferred an aristocratic lifestyle. The policy of citizenship-based taxation initially failed to consider business people's needs at all, undermining U.S. commerce right after World War I. Secretary of Commerce Herbert Hoover in the early 1920s championed excluding foreign-source earned income from U.S. taxation, but retained taxes on unearned income so that idle rich Americans in Europe wouldn't be rewarded for being "pensioners on the nation's resources", as he put it. Later policymakers' attention shifted to wealthy people who moved themselves or their work out of the U.S. to avoid tax. Kennedy in the 1960s brought in rules covering foreign trusts largely to stymy tax evasion by the wealthy. His administration also started taxing foreign earned income, albeit with such a high exclusion that one Kennedy administration official remarked only wealthy people like movie stars would be affected. Nonetheless, many measures brought in in the 1970s and 1980s, such as the temporary abolition of the foreign earned income exclusion and the limited rights of inheritance of non-U.S. spouses, affected a much broader swathe of Americans abroad than earlier provisions had.

B. Growing Role Internationally of Governments as Social Policy Providers

For historical reasons, the U.S. taxcode has long treated foreign unearned income harshly, but several trends have meant that poor and middle class people are more likely to have unearned income than in the past. The less well-off have benefitted from the development of social safety net programs. Many U.S. citizens abroad are not able to contribute to U.S. social safety net programs, such as Social Security, and have to rely on the countries where they live for social welfare provision. Unfortunately, most countries do not have tax treaties with the U.S. to prevent the U.S. from taxing foreign social security, unemployment or pensions payments. As a result, taxing unearned income has gone from being about taxing idle rich people who could be likened to "pensioners" on U.S. resources ninety years ago to nowadays affecting people who are often quite literally pensioners on other country's resources. The rationale for taxing foreign social safety net payments is not clear and this practice should be avoided.

C. New Forms of Social Policy Conflict with U.S. Tax Law

International trends in social policy since the 1970s have created even more conflicts with U.S. tax policy. Compared even with 1962, people are living longer and better lives due to more sophisticated medical care and better education. These trends have placed a great burden on governments everywhere. In the U.S. itself, 59% of the U.S. federal budget currently is spent on Medicare, Social Security and similar programs. Since the 1980s, U.S. experts and U.S.-supported institutions like the World Bank have endorsed the idea that governments should offer incentives or impose legal requirements to get their citizens to invest in government-approved funds for their future social needs. The U.S. itself has such programs, for example the 529 College Savings Plan and Individual Retirement Accounts, but non-residents are increasingly unable to open such accounts. Many countries have equivalents, but such programs often run afoul of U.S. foreign trust and Passive Foreign

Investment Corporation rules, so even small funds can require hundreds of dollars in annual paperwork.

Often there is no obvious U.S.-tax compliant strategy available, so good financial advice is essential, but financial advisers who can help clients live within two tax codes are rare and expensive. I know people who have felt compelled to renounce simply because they purchased index mutual funds to fund their retirements, a strategy that is often recommended to unsophisticated investors. Unfortunately, none of the funds available to them were U.S.-listed and they faced extremely high compliance costs, even though these funds were held in a type of account that the International Government Agreement with Britain classifies as providing limited risk of tax evasion.

Many countries have only agreed to provide the U.S. with banking information in the Intergovernmental Agreement on the condition that they do not have to provide information on the tax-advantaged social policy accounts of U.S. citizens who are their tax residents. The reporting of this type of account by individual taxpayers is essentially back to an honor system and the high costs of filing foreign trust and passive foreign investment corporation forms provides strong disincentives for compliance. Since these accounts are not useful for hiding large quantities of money offshored from the U.S. it would be extremely helpful if they could be exempted from foreign trust and PFIC filing requirements. The IRS will occasionally rule on whether a certain type of foreign tax-advantage account is a social policy account, but usually it does not, leading potentially to unaffordable filing costs. Compliance costs are regressive by nature since the cost of getting forms completed does not vary much depending on the size of the accounts involved. The reduction in the compliance burden would also reduce the controversy surround the taxation of some foreign tax-advantaged accounts, such as the Canadian Disability Savings Plan.

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D. Inflation Brings Poorer Individuals Into Increased Regulation

Tax law has also become more difficult over the last few decades because the dollar amounts stated in various tax laws have not been adjusted for inflation. For example, U.S. persons have been required to file Foreign Bank and Financial Account Reports (FBAR) since 1970 if they held at least $10,000 in overseas accounts at any time in a year. If that figure had been adjusted for inflation, the FBAR limit would now be $60,500 and many people of more modest means would not have to file the forms, which cost upwards of $100 a year to have completed professionally. Similarly, if the unit amount that a U.S. person can leave to a non-U.S. citizen spouse had been adjusted for inflation, it would be twice as high as it is now. These limits matter because compliance is expensive. Having an U.S. overseas tax return prepared costs at least $400 for someone living in an English-speaking country and the penalties for mistakes are high enough to devastate most people financially. To keep U.S. international taxation policy from becoming overly punitive, limits should be adjusted for inflation annually.

E. Poor and Middle Class Americans Find Regulations Harsh

The tax rules should be rewritten to make them less regressive. The tax rate used for foreign mutual funds outside of intergovernmental agreements should not be higher than the individual's income tax rate. The reason for taxing foreign mutual funds harshly is that financially sophisticated individuals can used them to convert earned income to capital gains, yet by taxing all foreign mutual funds at the top rate regardless of the individual's other income, U.S. tax law penalizes disproportionately those who are not already taxed at the top rate. Other provisions that are unduly harsh are the FBAR penalties. $10,000 is a great deal of money to most people and people who would never owe the U.S. tax are renouncing because they worry about reporting errors that would destroy them financially. Many U.S. citizens abroad are fond of the U.S., but know that they will never live there. U.S. citizens of modest means do not necessarily have access to the type of financial advice necessary to navigate two tax codes and cannot rely on the media, which is unreliable, or the IRS, which is underresourced. Basing penalties on a multiple of the amount owed would be fairer.

Why International Tax Reform Matters for Citizens Abroad

Thank you again for taking up this area of tax reform. There is considerable pessimism over whether Congress is actually interested in the needs of U.S. citizens abroad. Even those U.S. citizens abroad who have voting rights and are politically active find it difficult to get a response from their Senators and Representatives on these issues, perhaps because finance is complex. Unfortunately, legislators make it very clear on their official webpages that they only are interested in hearing from people who reside in their district. A poll conducted last year by Greenback Taxes found that sixty-seven percent of the U.S. citizens abroad felt that they were not fairly and adequately represented by the U.S. government. If the U.S. intends to continue tax U.S. citizens abroad, Congress must be interested in addressing their needs. If the Senate Finance Committee uses its expertise to create a fairer tax code for individuals abroad, its efforts will be greatly appreciate.