

Comment on the Federal Taxation of Overseas Americans

I am a United States citizen by birth, but I have lived and worked in Japan for my entire adult life. I am married with three children and work for an insurance company. I own various financial products in Japan, including bank accounts, life and medical insurance, a brokerage account and a defined-contribution type pension.

I pay taxes in Japan, where I fall into a 55% income tax bracket. While the amount of tax I owe to Japan is high, the requirements are easy to understand, and I can gather the relevant documents and prepare my own return, typically in a few hours on a Saturday afternoon.

The United States is the only industrialized country in the world which follows a citizenship-based (as opposed to residence-based) taxation system, so I am also required to declare and file U.S. Federal income taxes. This imposes an enormous cost and compliance burden, despite the fact that I typically owe very little tax due to the high marginal tax rate to which I am already subjected in Japan. It is extremely complex to apply U.S. Federal tax regulations to income earned overseas, so I cannot prepare my own returns, nor can I understand most of what is prepared on my behalf. My 2013 tax return was 64 pages in length. In each of the past 5 years, I have incurred more in tax preparation fees than the amount of tax I owed. On the other hand, I do not enjoy any benefits or services from the United States government such as infrastructure, education, healthcare or social security.

The compliance burden I face as a non-resident American is probably the single most stressful aspect of my life. I am required to disclose the details of all of my financial accounts on both an FBAR form filed with the U.S. Treasury and a Form 8938 attached to my tax return. The scope of the two filings overlaps partially, but the reporting criteria are different. The rules are opaque, and the penalties for even a non-willful mistake or omission are catastrophically high. Furthermore, due to the complexity of the FATCA compliance burden which financial institutions face, I have been refused products / services by both Citibank Japan and MetLife Japan, which would have been available to me if I were not a U.S. citizen. Conversely, I have been unable to open financial accounts in the United States because I do not have a U.S. address.

My tax burden is higher than it would be if I were not a U.S. citizen resident in Japan; in

fact, as a U.S. citizen, the U.S.-Japan tax treaty expressly limits the applicability of certain foreign tax credits which would otherwise reduce my Japanese taxes to compensate for taxes paid to the United States on financial income. The extent of the double taxation I face is only going to increase as I get older and begin to live off of pension / financial income rather than employment income, which enjoys certain exclusions and credits under the tax code.

Conclusions:

The United States should transition to a system of residence-based taxation, by changing the definition of a U.S. person in section 7701(a)(30) of the federal tax code.

By changing the definition of a U.S. person for tax purposes in the code (e.g. if a U.S. person meets the bona fide residence test or physical presence test for two or three consecutive tax years, they are no longer considered a U.S. person for federal income tax and reporting purposes). This is a change that should not need legislative action and would provide a lot of overseas Americans with tremendous relief. Americans in Japan and elsewhere outside the United States would be taxed on the same basis as non-resident aliens, primarily through a system of withholding taxes on passive U.S. source income (dividends, rents, pensions, etc.) and capital gains taxes on U.S. real estate; income earned in the United States would require filing a 1040NR. Americans abroad would remain subject to U.S. estate taxes on U.S. situs assets, including real estate and securities.

Furthermore, the Foreign Account Tax Compliance Act (FATCA) of 2010 should be reviewed in order to mitigate consequences unintended by the drafters of the legislation. Individual financial assets located in one's country of residence should not be subject to FATCA reporting obligations. A comprehensive review of FATCA would incorporate real world examples of the unintended consequences of the Act and allow for such modifications as necessary to remove those aspects which are causing financial institutions to refuse service to U.S. citizens.