Established 1973

4 rue de Chevreuse
75006 Paris, France
Tel: +33 (0)1 4720 2415
Website: www.aaro.org
Email: contact@aaro.org

Scoring the End of Citizen-based Taxation

Near the end of the last Congress Representative George Holding (R-NC) introduced a bill (HR 7358) permitting US persons who are not resident in the United States to opt out of Citizen-based Taxation (CBT). In effect, non-residents would no longer be liable for US tax on non-US source income.

A delegation from the Association of Americans Resident Overseas (AARO) discussed the bill with staff at the House Ways and Means Committee in June, 2019 and was informed that the bill was "dead" due to its "scoring". This means that the bill would cost money and contravene budget rules. Since it may be possible to mitigate a negative scoring by redesigning the bill and, in any case, inclusion of an unrelated "offset" to negate any budgetary impact is standard practice, we inquired about the amounts and the key elements of the underlying calculations. We were informed that while the scoring would be disclosed at an appropriate stage of the legislative process, for now it was secret. The methodology cannot be disclosed in any case.

Accordingly, we have scored the bill ourselves. On the basis that opting out of CBT requires at least 9 months of physical presence outside the United States, its annual cost appears to be in the range of $1.5-2.5 billion (Table 2 in Appendix), a small sum in the context of a $4.4 trillion federal budget only partially funded by individual income taxes running to $1.7 trillion.

Appendix: Trends in Overseas Filers' Income and Taxes and Costs of ending CBT

Table 1 summarizes the recent evolution of the main magnitudes involved. These partly reflect increasing awareness of reporting obligations that has accompanied enhanced enforcement efforts in recent years as well as economic developments. The number of returns filed with overseas addresses rose by about 3% p.a. from 2014 to 786,000 in 2017. This trend continued in 2018 but the removal of 76,000 returns from Puerto Rico from the data reduced this number to 739,000 in 2018. Total income reported on these returns has displayed little trend, notwithstanding a 25% spike (quickly reversed) in 2015[1], running around $83 billion in 2018. The "earned" component of this has consistently been in the range of 70-80% of the total. We estimate that around 80% of this is typically foreign source[2]. We have no basis for allocating passive income between US and foreign sources, although some items (e.g. social security benefits) appear to be mostly or entirely US source. Total US taxes paid on this income were $6.6 billion in 2018 ($6.9 billion if adjusted to retain taxes from Puerto Rico).

Table 2 reports the scoring. The left hand column summarizes the main tax magnitudes under current law ("citizen"-based taxation). $14.4 billion would have been due in 2018 with no allowance for foreign tax credits but such credits reduced this by more than half, to $6.5 billion. Other taxes (mainly self-employment and the net investment income tax) *less* offsetting credits accounted for the remaining $73 million in total US taxes due.

The cost of ending the taxation of non-US resident citizens' non-US source income, while leaving taxation of US-source income as now, is sensitive to two main variables. The first is the criteria for non-residence. Under current law, a foreign earned income "exclusion" is available to filers of Form 2555 if they meet one of two criteria: a strict "Physical Presence" test requiring filers to be physically present outside the United States for at least 330 days during any 12-month period; or a subjective "Bona Fide Residence" test. The former seems unduly restrictive for many people whose work and/or family considerations may reasonably warrant several visits to the United States a year. The latter may be subject to abuse by people who travel a great deal unless it is supplemented by some objective criteria. Inspection of the data suggests that this could be a concern for some non-resident high income filers who spend significant amounts of time in the United States. Taking account of

[1] This large variation reflects a 13% jump, to 7250 (less than 1% of the total), in the number of overseas filers reporting incomes of >$1 million and a 75% increase in their average income (to $5.35 million) in 2015. The rise in filers was fully reversed immediately and the jump in average incomes over two years. These data may be inherently volatile given the scope for rich people to move around and the small size of the group. Aggregate data, relating to both incomes and taxes, for the remaining 99% of overseas filers are very stable.

[2] Foreign source earned income is estimated by dividing foreign salaries and wages by total salaries and wages, based on Form 2555+EZ data, and multiplying by earned income of overseas filers from form 1040.

these considerations, we have scored ending CBT on the basis of a 3-month maximum presence in the United States.

The second variable is the share of non-residents' income that is US source and would continue to be taxed as at present. As noted, nearly 20% of non-resident filers' earned income is US source and we can estimate the tax that would remain due. Some passive income items, such as social security benefits, are clearly US source, so we can estimate the taxes that these would continue to generate. But we know little about the source of much of non-resident filers' passive investment income. Accordingly we consider a range of possibilities.

These are reported as scenarios without CBT on the right hand side of Table 2. The range is bound by the two extremes, i.e. that no passive investment income is US source and that all of it is. These define a (limited) range of $1.5-2.5 billion within which the cost of ending CBT must fall. Two intermediary estimates are also provided, one assuming an even split between US and non-US source across the board; and another assuming that the US share is the same as it is for earned income for all asset classes and income groups. These suggest costs of around $2.1 billion and $2.4 billion, respectively.

In summary, the cost of ending CBT is sensitive to the criteria, in terms of time present in the United States, for non-residence status. So long as this is restricted to those who remain outside the United States for at least 9 months annually, the cost is not very sensitive to the source of passive income. The necessary offset that will be required on any reasonable assumptions appears to be at most slightly over $2 billion annually.

We would be pleased to elaborate further with Ways and Means Committee staff at their convenience. Sources, methods and underlying worksheets are available at: https://docs.google.com/spreadsheets/d/13p2gwMtQiLZCyiBp_Fq6m8NJKChB6jL9GQdQJdNjQwk/edit?usp=sharing. The "variables" tab allows the analyst to consider alternative assumptions about the US share of passive investment income across asset classes and income groups. Contact: David Pinto (hdave@sbcglobal.net) or contact@aaro.org.

Table 1: Historical trends in overseas filers' income and taxes paid

US returns filed by individuals outside the United States*					
	(USD millions, except "Number of returns filed")				
	2014	2015	2016	2017	2018
Number of returns filed	718,040	751,190	764,570	785,940	739,140
Earned income	60,217	69,350	63,076	61,937	64,071
o/w US source	*13248*	*17235*	*11879*	*11237*	*11,818*
Foreign source	*46969*	*52114*	*51197*	*50701*	*52,252*
Passive investment income**	12,516	22,861	16,132	13,356	14,799
Other passive income***	4,297	4,582	4,481	4,672	4,284
Total income (sum of above)	77030	96793	83689	79965	83,154
Memo: Total US taxes due	*6,266*	11,149	*8,157*	6,815	6,614

*Includes Puerto Rico through 2017, excludes Puerto Rico in 2018

** Net capital gains, taxable interest and dividends.

*** Taxable IRA distributions, state and local tax refunds, unemployment compensation and taxable social security benefits, assumed throughout to be all US source, and taxable pensions and annuities

Table 2: Scoring the End of Citizen-based taxation (CBT)

US Taxes due from individuals outside the United States, 2018					
	(USD millions)				
	Current law	Ending CBT for non-residents			
	(outturns)	(at least 9 months outside US)			
US source share of passive income	*n.a.*	0%	As for earned income*	50%	100%
Total income	83,154	83,154	83,154	83,154	83,154
Taxable income**	57,681	32,014	32,708	34,197	36,930
Income taxes owed before foreign tax credits	14,433	9,364	9,505	9,779	10,274
less Foreign tax credits	7,891	5,145	5,145	5,145	5,145
Income taxes after foreign tax credits	6,541	4,219	4,359	4,633	5,129
plus Other US taxes *less* other credits***	73	-109	-97	-77	-47
Total US taxes due	6,614	4,110	4,262	4,556	5,082
Score: Cost of shift from current law to ending CBT	...	**2,504**	**2,352**	**2,058**	**1,532**

*US passive income share aligned with US earned income share for each income group and asset class.

**Under current law, after exclusions, deductions, exemptions.

***Mainly self-employment and net investment income taxes.

n.a. Not available. Totals may not add due to rounding.