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RESIDENCY-BASED TAXATION: A “BASELINE” APPROACH TO REPLACING CITIZENSHIP-BASED TAXATION

September 27, 2017

Congress and the Administration are expected to consider changes in US tax rules affecting the taxation of Americans abroad. This document, prepared by American Citizens Abroad, Inc. (ACA), provides a description of a “middle-of-the road” or “vanilla” approach to replacing citizenship-based taxation with residency-based taxation.¹ It is not intended as a legislative proposal but rather as a means of promoting careful consideration of this important subject.

TRANSITION FROM CITIZENSHIP-BASED TAXATION TO RESIDENCY-BASED TAXATION

Present Law

In general

Americans are taxed on the basis of their citizenship, not residency. A US citizen, no matter where he or she resides, is subject to US income tax, if certain income thresholds are met, and that individual must file a tax return with all the associated forms and schedules and pay tax. One of the associated forms requires reporting of information about Specified Foreign Financial Assets, including foreign deposit and custodial accounts and certain other foreign assets.² Special rules provide, as part of the regular income tax return, a foreign earned income exclusion, which can include a housing expense.³ This benefit, in effect, is a type of partial territorial tax treatment for some individuals. Upon an individual’s death, if the individual was a US citizen, his or her estate, if it is of a certain size, must file an estate tax return and pay estate tax with respect to its worldwide assets. Similarly, a US citizen is generally subject to gift taxation regardless where the individual resides and where the assets are situated. Other special rules deal with the tax treatment of expatriation.⁴ In addition, if certain thresholds are met, a US citizen must report foreign bank accounts.⁵ All other countries, with almost no exceptions, only tax residents of that country, that is, an individual is not subject to tax rules if he resides outside the country.⁶ There are many details affecting this subject, but this is the general “lay of the land”.

“Middle-of-the-Road” or “Vanilla” Approach to Residency-Based Taxation

The following describes a so-called “Vanilla” Approach to taxing US citizens and resident aliens on a residency basis as opposed to a citizenship basis. It provides information about what legislation to effect a change from citizenship-based taxation (“CBT”) to residency-based taxation (“RBT”) might look like. Based on this, decision-makers and interested parties can make or propose modifications. Importantly, it provides a starting point for preparing revenue estimates.

¹ This document, which revises a version dated February 7, 2017, is posted on the website of American citizens Abroad, Inc., <https://www.americansabroad.org/>. It was prepared by Charles M. Bruce, Legal Counsel, American Citizens Abroad, Inc. and Counsel, Bonnard Lawson-Lausanne. He is solely responsible for any errors. Glen E. Frost, Assistant Legal Counsel, and Partner, Frost & Associates, LLC-Maryland, contributed to this draft. Thanks go to all members of ACA Executive Committee and retired Director Jackie Bugnion. Comments, questions and corrections, all of which will be appreciated, should be directed to cmb@if.ch.

² Form 8938 (Statement of Specified Foreign Financial Assets).

³ The exclusion is claimed on Form 2555 (Foreign Earned Income).

⁴ See section 87 and 877A, dealing with expatriation to avoid tax and tax responsibilities of expatriation.

⁵ The filing of a Foreign Bank Account Report is a Bank Secrecy Act requirement, not an Internal Revenue Code requirement.

⁶ Exceptions are Eritrea, perhaps North Korea, and perhaps South Africa, all to various degrees.



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First published on December 5, 2016 in the form of a side-by-side comparison with current law⁷, it has been modified based upon comments received from ACA members and supporters, the public at large, and Congressional Members' and committee staffs. Comments by all concerned will be greatly appreciated.

New RBT rules, it should be noted, would operate only at the federal level. They might not influence state income, gift or inheritance rules. Also, these tax rules would not affect US immigration and nationality rules. The rules governing the issuance and renewal of a US passport would not change.

Taxpayers/Affected Individuals.

For federal income tax purposes, US citizens and resident aliens, including “green card” holders, would be taxed on a residency basis, i.e., generally tax only on US source income. Nonresident alien individuals would not be affected. Generally speaking, US citizens and resident aliens (“green card” holders and others) qualifying under the new provisions – herein called “non-resident Americans” – would be treated the same as nonresident alien individuals not living in the US. The definitions of US citizen and resident alien would be the same as those that exist under current law.

Normal sourcing rules in the Internal Revenue Code and bilateral income tax treaties, including provisions for reduced withholding tax rates, generally would apply. US source income would be taxed under the rules currently applicable to non-resident aliens. Likewise, existing effectively connected income (ECI) and Foreign Investment in Real Property Tax (FIRPTA) rules would be applicable. Thus, a US citizen residing outside the US and qualifying for the new rules would be taxed on business income, if he conducted a business in the US, and on gain from the sale of US real property.

As with nonresident alien individuals, Social Security benefits would be taxed as US source income. As is the case with US taxpayers residing in the US, benefits would be reported on Form SSA-1099 issued by the Social Security Administration. Taxes would be withheld if requested by the recipient. Any treaty provisions to the contrary would be overwritten. [Comments on this subject would be appreciated.]

Early withdrawals and required minimum distributions from an IRA or retirement plan would be taxed as US source income and subject to withholding. Treaty provisions to the contrary would be overwritten. Thus, these withdrawals would be taxed the same as they are if received by US taxpayers residing in the US. [Comments on this subject would be appreciated.]

Individuals could “opt out” of the new residency-based taxation rules simply by not applying for a Departure Certificate (discussed below). An individual might do this if, for example, he anticipated spending a good deal of time in the US and, therefore, in some years might become again taxable. He might not want to be bothered with “day-counting”. He might foresee running afoul of one of the anti-abuse rules, below. Also, he might not want his estate to be subject to what possibly might be a lower estate tax exemption.

Residency-based taxation would not be available to members of the armed services and diplomatic corps.

⁷ https://www.americansabroad.org/media/files/files/ad2154e6/Residency-Based_Taxation_ACA_Proposal_Side-By-Side_Comparison_161201_Final.pdf.



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Special definitions and other rules in bilateral income tax treaties would apply to non-resident Americans that otherwise qualify under the treaty's provisions. "Savings clauses" in tax treaties, which preserve the US's ability to tax its citizens, would be overridden in the statute.

The RBT rules would apply regardless of the fact that the US citizen or other individual in question was residing in a so-called "tax haven" and, therefore, was not subject to tax anywhere. As with the existing foreign earned income exclusion, there would be no requirement that to qualify the individual must be subject to income tax in another country. For example, an American living in Bermuda, which is a zero-tax country, and qualifying under US RBT rules would pay no tax in the US or Bermuda. Similarly, there would be no exception from the RBT rules for income from a so-called "sanctioned country", such as, Iran. Of course, other US laws might apply to make certain conduct illegal. [Comments on this subject would be appreciated.]

Qualification.

In order to qualify for residency-based taxation, an individual would have to satisfy the test for "qualified individual" under existing section 911 (Citizens or Residents of The US Living Abroad). In general, a "qualified individual" is an individual whose tax home is in a foreign country and who is (a) a US citizen and establishes that he has been a *bona fide* resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year or (b) a citizen or resident of the US and who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days in such period. An individual can qualify even though he or she is retired, is not "working", and receives no "earned income" but only earns, for example, interest, dividends and gains from a securities portfolio. He or she might be present in the foreign country but not comply with local rules, including immigration and employment rules.

Additionally, the residency test in current section 911, above, would have to be met for the most recent 5 taxable years prior to the year of claiming non-resident American status. The concern is that a US citizen or resident alien individual should not be able to "cash out" free of tax on holdings or businesses built up while he was fully taxable by simply moving abroad. He should be required to move abroad and remain there for a minimum of 5 years before becoming entitled to the benefits of RBT.

Special Rules for Citizens or Residents Abroad.

Section 911.

Section 911 (including both the foreign earned income exclusion and the housing cost amount) would be repealed. (See, however, "Effective Date; Transition Rules", below.)

Special Rules for Specified Short-Turn Overseas Employment.

There would be no special rules for individuals who do not satisfied the rules for a "qualified individual" because, for example, they reside overseas for relatively short periods of time. An individual might be on "temporary assignment" for, say, 3 years and come and go from the US on a regular basis. [Comments on this subject would be appreciated.]

Notwithstanding the foregoing, beginning any year including the year of enactment, individuals qualifying under existing residency rules (section 911(d)(1)) could elect section 911 treatment for up to 5 years, which period cannot be extended. This is a one-time election and cannot be revoked without the consent of the Secretary. Following this period, if individuals qualify for RBT treatment and wish to be taxed on a residency-basis, they can apply to the IRS for a Departure Certificate.



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Estate and Gift Taxation.

The estate of a non-resident American would be taxed the same as an estate of a non-resident alien individual which is not subject to US estate tax; in other words, in general, there would be no exposure to US estate tax. The estate, however, would be taxed on US property, including US real property and the shares of US companies, as this is the case with a non-resident alien's estate. It would be required to file an estate tax return if the fair market value at death of the decedent's US-situated assets exceeded \$60,000. Substantial lifetime gifts of US property by the decedent could reduce this figure. The "exemption" for estates with combined gross assets and prior taxable gifts of \$5,490,000 or less (2017 figure) would not apply. Thus, for the estate of an American residing outside the US and qualifying for the RBT rules, but subject to tax on a second home in the US, an estate tax might apply because the value exceeded the relatively low \$60,000 threshold, whereas an estate tax would not apply in the absence of the RBT rules. [Comments on this subject would be appreciated.]

In order to qualify for the unlimited exemption from estate taxation, the decedent must have qualified as a non-resident American for 3 full calendar years prior to date of death. For example, if date of death was July 1, 2021, the individual must have qualified under these rules for 2018, 2019 and 2020. The concern is that without this restriction, an individual – the individual's estate – could avoid US estate tax simply by beginning to reside abroad. Similarly, a non-resident American would be taxed the same as non-resident alien individual under current gift tax rules. Also, the donor would have to qualify as a non-resident American for 3 years prior to date of gift.

Grandfather Rule for Americans Abroad.

Americans resident outside the US for a period including the most recent 3 calendar years prior to year of enactment would be treated as "non-resident" for purposes of these estate and gift tax rules. In other words, if date of enactment was December 6, 2017 and an individual was a "qualified individual" in 2014, 2015 and 2016 and the first 8 months of 2017, his or her estate would not be subject to US estate taxation.

Filing Requirement.

Individuals who qualify and who wish to be taxed on a residency-basis would be required to apply to the IRS for a Departure Certificate. Non-resident American status would commence with the date of issuance of the Departure Certificate. An individual could not cease to file tax returns and pay US tax simply because he moved abroad and did nothing else. He would have to take actions to place himself in the category of a non-resident American.

The year of issuance of a Departure Certificate would be a split year. For the year of issuance, a qualified individual would file a dual return (Form 1040NR and Form 1040). For example, for an American residing abroad who came within the "Grandfather Rule", above, if the year of issuance of a Departure Certificate was 2018 and date of issuance was July 1, 2018, for taxable year 2018, she would file a dual return Form 1040NR with Form 1040 attached, reporting income for January 1-June 30, 2018 on the Form 1040 and any income for July 1-December 31, 2018, which might be, for example, income from the sale of US real property, on Form 1040NR. This approach is similar to the approach applicable to an individual who renounces US citizenship.

Non-resident Americans with effectively connected income would file a Form 1040NR.



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There would be no requirement that a non-resident American report a change of residence from one foreign country to another.

Any individual claiming RBT would be required to file an annual certification stating under oath that he/she is a US citizen or resident alien and fulfils the residency requirements for the taxable year (including the 5-year rule, above), and does not have income related to a “restricted country”. Failure to file an annual certification would terminate the individual’s status as a non-resident American. The concern is that without some on-going responsibility to maintain the status, individuals might return to the US, live in the US and improperly avoid paying US tax.

Departure Tax Provision.

General Rule. Individuals who obtain a Departure Certificate and meet the threshold test of current section 877 (Expatriation to Avoid Tax), would be subject to tax on income as if property was sold on the day before the date of the Departure Certificate. The concern is that if there is not some form of Departure Tax, individuals could accumulate wealth while being a US citizen living in the US, and then avoid any US tax by simply moving abroad. Not only might this be the wrong result from a tax policy standpoint, it would greatly increase the revenue costs of instituting RBT. [Comments on this subject would be appreciated.]

Threshold tests for application of the Departure Tax would be the same as those in section 877, except the \$2 million or more figure in section 877(a)(2)(B) would be increased to \$5 million and US real estate subject to FIRPTA rules would be excluded. Rules similar to those in sections 877 and 877A would apply to pensions and other forms of deferred compensation and interests in trusts. [Comments on this subject would be appreciated.]

Special Rule for Americans Abroad. Individuals meeting the residency test for RBT for at least 3 years prior to date of enactment of these rules and who certify under penalty of perjury that they have been tax compliant, would not be subject to the Departure Tax. [Comments on this subject would be appreciated.]

IRS User Fee. Under current law, there is a State Department fee of \$2,350 charged for renunciation of US citizenship. Under the RBT approach, there would be a one-time IRS User Fee for issuance of a Departure Certificate equal to the State Department’s then applicable renunciation fee. Americans abroad qualifying for the special 3-year rule, above, would not be subject to this User Fee. [Comments on this subject would be appreciated.]

Special Rule-“Covered Expatriates”. Under current law, there are special rules taxing bequests and gifts to US persons from a so-called “covered expatriate” (in general, certain US citizens who relinquish citizenship and certain long-term US residents who cease to be a lawful permanent resident). These are taxed to the recipient at the highest estate tax or gift tax rate then applicable. The RBT approach contains no comparable provision. Non-resident Americans are not treated as a “US person” for purposes of these rules.

Effective Date; Transition Rules

In the first year that an individual holds a Departure Certificate, days spent in the US would not count for determining his or her status as resident. For example, if an individual was issued a Departure Certificate on July 1, 2018, but did not begin to reside in a foreign country until September 1, 2018, days spent in the US during 2018 would not count for purposes of determining the individual’s status for 2018. His or her “beginning date”, however, would be July 1, 2018.



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The beginning date for residency-based tax status for an individual would be the date of issuance of the Departure Certificate. It would not be retroactive to an earlier date.

Residency-based taxation, in effect, could be elected for a taxable year by an eligible individual by obtaining a Departure Certificate. Status as a non-resident American would remain in effect so long as the individual qualifies and files an annual certification that he/she qualifies or until the individual files with the IRS a request for termination of election and such request is approved.

The RBT provisions would be effective for taxable years beginning after the date of enactment. For example, if the provisions were enacted on December 6, 2017, they would be effective for calendar years 2018 and thereafter. An individual who has received a Departure Certificate would be treated as having commenced a new taxable year as of the date of issuance of the Departure Certificate. [Comments on this subject would be appreciated.]

Transition Rule; Special Election. Individuals not wishing to elect RBT treatment could elect section 911 treatment to be applied to the taxable year of enactment plus three successive taxable years thereafter. These years reduce the number of years covered by the special one-time election for Short-Turn Overseas Employment (above).

Anti-Abuse Rules

Gain from sale or disposition of securities for a 2-year period following issuance of a Departure Certificate would remain taxable as under current law, regardless whether linked to prior employment in the US. Thus, if an individual residing in the US changes were to move abroad (change residence to a foreign residence) and sell or dispose of securities within 2 years of obtaining a Departure Certificate, gain would remain subject to US tax. [Comments on this subject would be appreciated.]

Issuance of a Departure Certificate would require proof that individual is a resident of a foreign country and is subject to taxation in that country on the same basis as others who are residents there. There would be no requirement that the country impose an income tax. For example, an individual could reside in Bermuda, which is a zero-tax country. [Comments on this subject would be appreciated.]

Issuance of a Departure Certificate would require proof that the individual in question has met all federal tax requirements. This is similar to the requirement for US resident aliens and nonresident aliens (with certain exceptions) to obtain an IRS tax clearance document, commonly referred to as a "sailing permit".

Individuals eligible for the special rule for individuals residing abroad (RBT rules, above) would be subject to the Departure Tax, whether or not they are tax-compliant. The date of departure for such individuals would be the subsequent date of issuance of a valid Certificate.

If an individual who was a non-resident American for any of the prior 5 years and was a resident American for any year prior to that period, and again becomes a resident American, then he or she shall be treated as a resident American for each of the prior five years. Otherwise, a returning non-resident American will be treated the same as a non-resident alien who becomes a resident alien for US tax purposes. The concern is that an individual not be able to remove himself from US tax status, then realize income which is not subject to US tax, and subsequently again become subject to US tax rules. This rule mirrors the 10-year rule for expatriates authorized by section 877(e)(5).



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FATCA; FBAR Filing Requirement

The “Hiring Incentives to Restore Employment Act” (“HIRE Act”), enacted in March 2010, included the “Foreign Account Tax Compliance Act” or “FATCA”. These provisions, among other things, created voluminous new Chapter 4 withholding tax rules. They also created the requirement for taxpayers to file a Statement of Foreign Financial Assets (Form 8938), overlapping, to a significant degree, the Foreign Bank Account Reporting requirements.

FATCA. FATCA would not be repealed. [Comments on this subject would be appreciated.]

“Same Country” Exemption. FATCA contributes to the “lockout” of Americans abroad from foreign banking services. This is one of the principal reasons supporting a repeal of FATCA. FATCA would be amended to add a “same country” exemption for certain accounts of individuals residing in a foreign jurisdiction, where the account is with a foreign financial institution in the same country where the individual resides.

Form 8938. FATCA adds to the paperwork burden on persons, including Americans abroad, who have foreign bank accounts, which they use in the normal course. FATCA would be further amended with respect to the requirement to file Form 8938 as an attachment to a Form 1040. This requirement would be changed so as to allow any US taxpayer, not simply individuals qualifying for the RBT, to not file a Form 8938 if the only foreign financial assets that would have been reported on such form had been properly reported on a Foreign Bank Account Report. The filer would certify to this effect. [Comments on this subject would be appreciated.]

FBAR Reporting. Existing rules requiring the filing of Foreign Bank Account Reports (FBARs) would not be changed. These rules were first enacted in 1970 as part of the Bank Secrecy Act and are ordinarily treated as separate from the tax rules in the Internal Revenue Code. FBAR reporting is defended as a means of combating terrorism, illegal drug trafficking and other money-laundering schemes, as well as the use of foreign financial accounts to evade taxation. [Comments on this subject would be appreciated.]

American Citizens Abroad, Inc. is a membership organization incorporated as a nonprofit organization under the laws of the State of Delaware. It is an exempt social welfare organization (I.R.C. § 501(c)(4)). Alongside it is American Citizens Abroad Global Foundation (ACAGF), which is a publicly-supported charity (I.R.C. § 501(c)(3)). ACA and ACAGF favor a balanced approach to subjects, supporting efforts that provide tangible results. They are nonpartisan. They do not support or campaign for any candidates. Neither provides tax, legal, accounting, or investment advice.



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American Citizens Abroad

Side-By-Side Analysis:

Current Law; Residency-Based Taxation

27 September 2017

INTRODUCTION

This side-by-side analysis compares Current Law (i.e., citizenship-based taxation rules in the Internal Revenue Code) and a possible approach to residency-based taxation. The column labelled “Current Law – Citizenship-Based Taxation (‘Current Law’)” summarizes present law. The column labelled “Residency-Based Taxation” describes one possible approach to taxing US citizens and resident aliens according to their residency rather than citizenship. This approach is intended to set forth a detailed version of new statutory and treaty rules, which then can be modified as desired. It also provides a starting point for preparing revenue estimates.*

Current Law – Citizenship-Based Taxation	Residency-Based Taxation
US citizens and resident aliens, including “green card” holders, residing overseas are taxed the same as these individuals residing in the US. Special provisions can provide some benefits for earned income. Special rules, including a mark-to-market rule (exit tax), can apply to expatriates.	US citizens and resident aliens, including “green card” holders, residing overseas, in general, would be removed from the category of individuals subject to US income tax and placed in the same category as nonresident aliens (foreign individuals). Various conforming changes would be made.
Taxpayers/Affected Individuals	Taxpayers/Affected Individuals
For federal income tax purposes, US citizens and resident aliens generally taxed on worldwide income regardless of source of income or other factors.	For federal income tax purposes, US citizens and resident aliens, including “green card” holders, taxed on residency basis, i.e., generally taxed only on US source income and income effectively connected with a US trade or business.
Citizenship defined by nationality laws. Includes, with very narrow exceptions, all individuals born in the US regardless of nationality of parents; naturalized citizens; and certain individuals born overseas to a US parent. “Resident alien” defined by income tax rules in section 7701(b) (physical presence and “green card” test).	Same as current law.
Citizens and residents taxed on worldwide income at graduated rates on regular income rising from 15% to 39.6% with variations depending upon filing status, i.e., married filing joint returns and	Same as current law.



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surviving spouses, heads of household, unmarried individuals, married individuals filing separate returns. Taxed on worldwide adjusted net capital gains generally at 15% or 20%. A 3.8% net investment income tax can apply where modified adjusted gross income exceeds \$250,000 for joint returns and surviving spouses, \$125,000 for separate returns and \$200,000 in other cases, bringing overall rate to 23.8%.

Special tax rules can apply to individuals who expatriate, including mark to market rules (so-called “exit tax”).

Non-US citizens and non-resident alien individuals generally subject to US withholding tax, at 30% rate or reduced rate pursuant to a treaty, only on certain US source income, including interest (other than so-called “original issue discount”), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other “fixed or determinable annual or periodical gains, profits”. Also, subject to graduated rate of tax, same as US citizen or resident on income effectively-connected with a US trade or business. Section 871(a) & (b). Income from US real property generally taxed under Foreign Investment in Real Property Tax (FIRPTA) rules (§897); collected by withholding. Capital gains are generally exempt from tax under the Internal Revenue Code. Foreign tax credits can be claimed to offset US tax, but not to the extent of foreign taxes that are allocable to income excluded under foreign earned income exclusion (see below).

Social Security benefits are included in gross income in any year the sum of half the taxpayers Social Security plus all other income, including tax-exempt interest, exceeds \$25,000 (32,000 married filing jointly). They are reported on a Form SSA-1099 issued by the Social Security Administration. Taxes withheld only if requested by the recipient.

Generally, early withdrawals (before age 59½) from an IRA or retirement plan are taxed with a 10% early withdrawal tax. Required minimum distributions from IRAs, but not Roth IRAs, beginning at age 70½, are taxed as ordinary income.

Non-resident taxpayers not subject to “exit tax”, but see Departure Tax Provision, below.

Non-resident taxpayers (US citizens and resident aliens – green card holders and others) are subject to taxation the same as non-resident alien individuals. Normal sourcing rules in the Internal Revenue Code and bilateral income tax treaties, including provisions for reduced withholding tax rates, apply. §§861-865. US source income is taxed under rules applicable to non-resident aliens. §§871-898. Likewise, effectively connected income (ECI) (§871(b)) and Foreign Investment in Real Property Tax (FIRPTA) rules (§897) are applicable. Capital gains are exempt.

Social Security benefits taxed as US source income as with nonresident alien individuals. Section 871 (a)(3). Benefits are reported on a Form SSA-1099 issued by the Social Security Administration. Taxes withheld if requested by the recipient. Treaty provisions to the contrary are overridden.

Early withdrawals and required minimum distributions taxed as US source income and subject to withholding. Treaty provisions to the contrary are overridden.



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<p>No provision tied to “tax haven” status applies individuals.</p>	<p>Individuals can opt out of residency-based taxation (RBT) by not applying for a Departure Certificate (see below).</p> <p>Residency-based taxation is not available to members of the armed services and diplomatic corps.</p> <p>Special definitions and other rules in bilateral income tax treaties apply to non-resident taxpayers that otherwise qualify under the treaty’s provisions. “Savings clause” does not apply.</p> <p>No provision tied to “tax haven” status.</p> <p>Residency in a “sanctioned country” does not qualify for purposes of residency-based taxation rules.</p> <p>Income from a “sanctioned country” does not qualify for residency-based taxation treatment.</p> <p>In order to qualify for residency-based taxation, same residency test as current section 911, except individual must have met the test for the most recent 5 taxable years prior to the year of claiming non-resident American status (“aging test”).</p>
<p>Special Rules for Citizens or Residents Abroad</p>	<p>Special Rules for Citizens or Residents Abroad</p>
<p>Section 911</p>	<p>Section 911</p>
<p>US citizens and resident aliens can qualify for exclusion from taxable income comprised of eligible foreign earned income exclusion and a housing cost amount under section 911.</p> <p>In order to qualify for section 911, residency test must be met. Individual’s “tax home” must be in a foreign country and the individual must be a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year or be present in a foreign country for at least 330 full days during a period of 12 consecutive months. Section 911.</p>	<p>Section 911 (including both foreign earned income exclusion and a housing cost amount) is repealed. (See “Effective Date; Transition Rules”, below.)</p> <p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p>



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<p>Foreign earned income exclusion annual amount is currently \$102,100 (for 2017). Housing cost amount in general equals the excess of housing expenses over a figure tied to 16% of the salary of a US Government employee (Grade GS-14).</p> <p>Housing cost amount can be increased for certain locations with high housing costs compared to the US. E.g., Notice 2014-29, 2014-18 IRB 991.</p> <p>Foreign earned income and housing expenses do not include income or expenses related to a “sanctioned country” (essentially a country that has been designated as repeatedly providing support for acts of international terrorism, one as to which the US has severed or does not conduct diplomatic relations, etc.).</p> <p>No requirement that to qualify for foreign earned income exclusion, individual must be subject to income tax in another country.</p>	<p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p> <p>Section 911 is repealed.</p>
<p>Special Rules for Short-Turn Overseas Employment</p>	<p>Special Rules for Short-Turn Overseas Employment</p>
<p>No provisions.</p>	<p>Beginning any year, individuals qualifying under existing residency rules (section 911(d)(1)) can elect section 911 treatment for up to 5 years, which period cannot be extended. This is a one-time election and cannot be revoked without the consent of the Secretary. Following this period, if individuals qualify for RBT treatment and wish to be taxed on a residency-basis, they can apply to the IRS for a Departure Certificate.</p>
<p>Estate and Gift Taxation</p>	<p>Estate and Gift Taxation</p>
<p>For federal gift and estate tax purposes, US citizens and residents subject to gift and estate tax with respect to worldwide assets. Estates with combined gross assets and prior taxable gifts of \$5,490,000 or less (2017 figure) are not required to file an estate tax return. Citizenship defined by nationality laws. “Resident” generally defined by estate tax rules in regulations (Reg. §20.0-1(b) (essentially domicile, following common law principles)).</p>	<p>Estate of non-resident American taxed as estate of non-resident alien (i.e., taxed only on US property) not subject to US estate tax.</p> <p>Same as current law (\$60,000 threshold).</p>



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<p>Non-residents' estates must file an estate tax return if the fair market value at death of the decedent's U.S.-situated assets exceeds \$60,000. Substantial lifetime gifts of U.S. property by decedent can reduce this figure. Estate and gift tax applies to U.S. property including, only as to gift tax, shares in U.S. corporations. Assets in U.S. bank accounts generally are exempt.</p>	<p>In order to qualify, decedent must have qualified as a non-resident American for 3 years prior to date of death.</p> <p>Non-resident American generally taxed the same as non-resident alien individual under current gift tax rules. Donor must have qualified as a non-resident American for 3 years prior to date of gift.</p> <p>American outside the US for most recent three calendar years prior to year of enactment is treated as "non-resident".</p>
<p>FATCA; Payroll Taxes</p>	<p>FATCA; Payroll Taxes</p>
<p>The "Hiring Incentives to Restore Employment Act" ("HIRE Act"), enacted in March 2010, included the "Foreign Account Tax Compliance Act" or "FATCA". These provisions, among other things, created voluminous new Chapter 4 withholding tax rules. They also created the requirement for taxpayers to file a Statement of Foreign Financial Assets (Form 8938), overlapping, to a significant degree, the Foreign Bank Account Reporting requirements.</p>	<p>FATCA would not be repealed.</p> <p>A "same country" exemption for certain accounts of individuals residing in a foreign jurisdiction, where the account is with a foreign financial institution in the same country where the individual resides, would be added to the Internal Revenue Code. This helps US citizens resident abroad who for whatever reason are not "covered" by RBT rules.</p> <p>The rules underpinning Form 8938 would be changed: If an individual only had foreign deposit and custodial accounts, which had been reported on a Foreign Bank Account Report, he or she would not be required to file Form 8938.</p> <p>There would be no changes in existing payroll tax rules.</p>



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Filing Requirement	Filing Requirement
<p>Taxable citizens and residents must file a Form 1040 and, where applicable, a Form 2555 (Foreign Earned Income), Form 1116 (Foreign Tax Credit) and Form 8938 (Statement of Foreign Financial Assets).</p> <p>Non-US citizens and non-resident alien individuals must file a Form 1040NR if engaged in a US trade or if they received business or fixed or determinable annual or periodical gains, profits, e.g., interest, dividends, etc., that were not withheld upon. The FIRPTA tax is collected by withholding (§1445). No filing required with respect to US capital gains.</p>	<p>Non-resident taxpayers are generally treated as non-resident aliens and, therefore, do not file Form 1040, Form 2555, Form 1116, or Form 8938.</p> <p>Qualifying individuals wishing to be taxed on a residency-basis are required to apply to the IRS for a Departure Certificate. Non-resident taxpayer status commences with date of Departure Certificate.</p> <p>Year of issuance of Departure Certificate is a split year, and individual files a dual return (Form 1040NR and Form 1040).</p> <p>Non-resident taxpayers with effectively connected income file a version of Form 1040NR.</p> <p>No provision for reporting change of residence from one country to another.</p> <p>Any individual claiming Residency-Based Taxation must file an annual certification stating under oath that he/she is a US citizen or resident alien, fulfils the residency requirements for the taxable year (including the 5-year rule, above), and does not have income related to a “restricted country”. Failure to file annual certification terminates status as non-resident American.</p>
Departure Tax Provision	Departure Tax Provision
<p>A US citizen who renounces or a long-term US resident who gives up residence status and who meets certain tests is treated as a “covered expatriate”. All property of such individual is treated as sold on the</p>	<p>Individuals obtaining a Departure Certificate and meeting the threshold test of current section 877 (Expatriation to avoid tax) are subject to tax</p>



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<p>day before the expatriation date for its fair market value (“exit tax”). The first \$600,000 (adjusted for cost-of-living increases; \$680,000 for 2014) is excluded. Sections 877 & 877-A.</p> <p>Threshold tests are individual has average annual net income tax of greater than \$124,000 (adjusted for cost-of-living increases; \$157,000 for 2014) over most recent 5 years or a net worth of \$2,000,000 or individual fails to certify under penalty of perjury that he or she is tax compliant for the 5 preceding taxable years.</p> <p>Bequests and gifts to US persons from “covered expatriate” are taxed to recipient at highest estate tax or gift tax rate.</p> <p>State Department fee of \$2,350 charged for renunciation.</p>	<p>on income as if property was sold on the day before the date of the Departure Certificate.</p> <p>Threshold tests are the same as those in section 877, except \$2 million or more figure in section 877(a)(2)(B) increases to \$5 million and US real estate subject to FIRPTA rules is excluded. Rules similar to those in sections 877 and 877A applicable to pensions and other forms of deferred compensation apply.</p> <p>US real estate subject to FIRPTA rules is excluded.</p> <p>Special Rule (“Grandfather” Rule) for Individuals Residing Abroad. Individuals meeting the residency test for residency-based taxation for at least 3 years prior to date of enactment of these rules and who certify under penalty of perjury that they have been tax compliant, would not be subject to the Departure Tax.</p> <p>No provision. Non-resident American is not treated as a “US person”.</p> <p>One-time IRS User Fee equal to the State Department’s then applicable renunciation fee. Americans abroad qualifying for the special 3-year rule, above, would not be subject to this User Fee.</p>
<p>Effective Date; Transition Rules</p>	<p>Effective Date; Transition Rules</p> <p>RBT is effective date of enactment, for taxable years following date of enactment.</p> <p>Repeal of section 911 is effective date of enactment. Transition Rule; Special Election: Individuals not able to or not wishing to elect RBT treatment can elect section 911 treatment to be applied to the taxable year of enactment plus three successive taxable years thereafter. These years reduce the number of years covered by the special one-time election for Short-Turn Overseas Employment (above).</p>



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	<p>In first year that individual holds a Departure Certificate, days spent in the US do not count for determining status as resident.</p> <p>Beginning date for residency-based tax status is date of issuance; it cannot be retroactive to an earlier date.</p> <p>Residency-based taxation, in effect, may be elected for a taxable year by an eligible individual by obtaining a Departure Certificate. Status as a non-resident American remains in effect so long as the individual qualifies and files annual certification that he/she qualifies, until the individual files with the IRS a request for termination of election and such request is approved.</p> <p>If individual has fulfilled applicable requirements, he/she can immediately claim residency-based tax treatment for any taxable year following the effective date. Such treatment cannot be claimed for past open years.</p>
Anti-Abuse Rules	Anti-Abuse Rules
	<p>Gain from sale or disposition of securities for a 2-year period following issuance of a Departure Certificate remains taxable as under current law, regardless whether linked to prior employment in the US. Thus, if an individual residing in the US changes moves abroad (changes US residence to a foreign residence) and sells or disposes of securities within 2 years of obtaining a Departure Certificate, gain will remain subject to US tax.</p> <p>Issuance of a Departure Certificate requires proof that individual is a resident of a foreign country and is subject to taxation in that country on the same basis as others who are residents there.</p> <p>Issuance of a departure certificate requires proof of payment of all US income tax liabilities.</p> <p>Individuals eligible for the special rules for individuals residing abroad, above, would be subject to the Departure Tax, whether or not they are tax-compliant. The date of departure for such individuals is the subsequent date of issuance of the Certificate.</p>



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	<p>If an individual who was a non-resident American for any of the immediately prior 5 years and was a resident American for any year prior to that period, and again becomes a resident American, then he or she shall be treated as a resident American for each of the prior years as to which, absent this rule, such individual would be treated as non-resident. Otherwise, a returning Non-Resident American will be treated the same as a non-resident alien who becomes a resident alien for US tax purposes.</p>
<p style="text-align: center;">FBAR Filing Requirement</p>	<p style="text-align: center;">FBAR Filing Requirement</p>
<p>US persons, including individuals, companies, partnerships, trust, estates, etc., are required to file annually Foreign Bank Account Reports if they meet certain threshold tests relating to ownership and “signature power” and size of the account. Individual includes US citizen or resident alien as defined in section 7701(b).</p>	<p>Same as current law.</p>

* This Side-By-Side Analysis is intended to promote careful consideration of this important subject. It was developed by ACA and first published on 5 December 2016 and revised on 7 February 2017. It is not a legislative proposal, *per se*. This document was prepared by Charles M. Bruce, Legal Counsel, American Citizens Abroad, Inc. Mr. Bruce is Of Counsel, Bonnard Lawson-Lausanne. He is solely responsible for any errors. Thanks go to all members of ACA Executive Committee and retired Director Jackie Bugnion. Comments, questions and corrections, all of which will be greatly appreciated, should be directed to cmb@ifl.ch.

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FREQUENTLY ASKED QUESTIONS ABOUT CONVERSION TO RESIDENCY-BASED TAXATION

Is ACA's RBT "Vanilla" Approach the definitive version of a residency-based proposal?

The "Vanilla" Approach is not an ACA "proposal" per se. Rather it is a starting point for examining how citizenship-based taxation (CBT) might be replaced with residency-based taxation (RBT) and what the new rules might look like. By working off a "Vanilla" Approach, it is easier to compare a variety of versions.

RBT works on the premise that Americans overseas should be taxed in essentially the same manner as Non-Resident Aliens (NRAs). US source dividends, interest, and royalties, and income effectively-connected with the US trade or business, would be taxed in the same way it is when earned by an NRA. Income sourced from outside the US would not be taxed.

The "Vanilla" Approach addresses all or most of the issues that we think should be considered.

What is scoring? Why does RBT need to be scored? What will scoring tell us, and why not have Congress do this work?

Major tax reform legislation will not pass the Congress without "scoring", that is, development of revenue estimates, which tell Congress how much revenue will be lost or gained by enactment of the legislation. Advocating successfully for a proposal for this kind of major tax reform for Americans overseas cannot be done based on simple assertions such as: It is fairer, it is the right thing to do or, it is how all other industrialized nations tax their citizens.

A proposal describing the specific amendments to existing law necessary to transition from CBT to RBT, we think, can best be developed after putting on the table all the essential pieces and, very importantly, estimating the revenue costs. Many of the revenue costs will tie to particular parts, such as "grandfather" and "transition" rules. "Grandfather" rules, for example, make individuals who are living overseas, and have been living overseas for some specific period of time, automatically qualified for RBT treatment, without them having to do anything further. "Transition" rules might phase-in certain provisions.

It is only through the process of scoring a "Vanilla" Approach that we can determine which elements need to be included, excluded, refined, etc., and whether certain topics (e.g., estate and gift tax) should be addressed. The scoring is intended to help everyone determine what is the best RBT proposal for the diverse population of Americans overseas.

Why should organizations like ACA drive the tax reform process for Americans overseas?

Changes in the current approach for taxing Americans abroad will need to be made legislatively, by Congress. Treasury Department will play an important role in formulating policy. This work is happening in Washington, DC. ACA's team is readily available to the offices involved in tax reform and is developing the information and working with decision-

makers in Congress and elsewhere to effect a change from CBT to RBT. A number of criteria relating to revenue costs and placement of provisions within the existing Internal Revenue Code will need to be dealt with. ACA is preparing to do just this.

As most Americans overseas know, there is no collective voice in Congress for this constituency. Americans overseas vote from the State and District in which they last lived. Identifying legislators with a thorough understanding of the community's issues and a deep-seated interest in addressing them is not an easy matter. ACA believes that leaving legislation such as this up to individuals in Washington, DC who do not have an understanding of the needs of this community, would be counter-productive and, worse yet, might produce a proposal that creates more problems for Americans overseas that it solves.

ACA believes that our organization, along with others serving the overseas community, are best positioned to describe how an RBT system might be structured.

ACA's approach seems complicated. If the policy intends to treat Americans overseas as NRAs, why not just say that?

RBT is a set of tax rules treating Americans residing abroad the essentially the same as nonresident aliens. We say this in various places. For example, in describing "Residency-Based Taxation 'Vanilla' Approach", we say: "US citizens and resident aliens, including 'green card' holders, residing overseas, in general, would be removed from the category of individuals subject to US income tax and placed in the same category as nonresident aliens (foreign individuals). Various conforming changes would be made."

The more detailed topics, or "complicated bits", have to do with such things as defining who will qualify, saying what to do with "leftover luggage", such as the foreign-earned income (section 911) exclusion, talking about estate and gift tax rules, filing requirements, effective dates, and so forth. In addition, there needs to be a defined path for how individuals bring themselves within RBT. If not, it leaves the proposal open to loopholes for tax evasion, which would cause the revenue estimates for enactment to skyrocket.

The basic underlining change to the existing tax code is to treat Americans abroad the same as nonresident aliens. ACA believes that it is best and simplest to work with the fabric that exists and to offer a proposal that does not require many "cuts" to the current tax code, as opposed to writing new and novel provisions from scratch, which would be complicated and difficult to draft and to explain. It also makes it easier to develop reliable revenue estimates.

Why should RBT be revenue neutral? Shouldn't RBT be argued on fairness and the fact that it will help Americans to be more competitive?

There is no way to know with certainty how the Congress will address tax reform. Will Congress evaluate proposals based on static or dynamic scoring, the later taking into account changes in behavior? What assumptions will be made about future economic growth? Will Congress look at the larger picture or focus on particular elements of the Internal Revenue Code?

Some may argue that with greater tax reform in the works, there will be offsets in other areas of the Code that would increase revenue and, therefore, offset any revenue loss from the

implementation of RBT. Due to the uncertainty about how Congress will address tax reform, ACA's belief is that the best way forward is to provide Congress with a road map that is revenue neutral; neither increasing nor decreasing revenue. Also, if RBT is a "revenue loser", then some – especially those who only reside in the US – might say that they should not, in effect, have to subsidize tax relief for Americans residing abroad.

There are arguments for "selling" RBT based solely on how RBT would increase competitiveness. Although not impossible, this argument is difficult to quantify. ACA believes that RBT will unleash Americans, giving them the freedom to be more mobile and to create more economic opportunity for America and Americans through greater engagement internationally. Although revenue estimates for this behavioral change can be made, Congress may rely more on what can concretely be proved. How much revenue will flow out, and how much revenue will flow in based on the numbers? ACA believes it is better to use a model that can demonstrate how revenue flows would operate under RBT, rather than use modeling that is more subjective in nature.

Why fight uphill and have to defend a loss of revenue when you can present a proposal that is revenue neutral?

What about Accidental Americans and RBT? Won't they pay a heavier price of entry into RBT?

ACA tries to avoid categorizing "Americans" in this way. ACA is seeking a way forward with tax reform that meets the needs of all Americans overseas. That said, our approach provides a path for those Americans residing abroad who were born in the United States and left as infants or young children (living primarily outside of the US and as a citizens of a foreign jurisdiction) and for those who have no real ties to the United States and may have obtained US citizenship from a parent/grandparent.

Most Americans who have resided long-term abroad will immediately qualify for RBT treatment. Moreover, if they have resided abroad for at least three years prior to date of enactment of RBT and if they are tax compliant, they will not be subject to a "Departure Tax" and will not be subject to a one-time User Fee – that is, they will be "grandfathered" under the rules. For those who are not tax compliant, they normally would be eligible to enter the Foreign Streamlined Compliance Program, which ACA recommended to the IRS and which was improved upon and finally adopted by the IRS. This should allow most individuals who were unaware of their filing requirements or non-willful in their failure to file, to become compliant without the application of penalties. That said, not everyone may qualify, and some electing RBT treatment may incur back-taxes and penalties. However, it does give the overwhelming majority of these individuals a path forward while trying to be fair to everyone seeking to opt into RBT.

Why not address FBAR in the "vanilla" approach and exclude Americans overseas from the obligation to file FBARs (FinCEN Report 114)?

FinCEN Report 114 (Report of Foreign Bank and Financial Accounts (FBAR)) filing is required under Title 31 as part of the Bank Secrecy Act and is not under any provisions of the Internal

Revenue Code (i.e., it is not a tax-reporting form). FBAR reporting is more about national security and crime prevention than tax compliance.

The perception of many individuals is that FBAR is a tax-reporting tool, when, in fact, it is about prosecuting criminal behavior. If the Government can't "get" criminals "in the act", they will get them on a technicality: failure to file an FBAR. Individuals may have differing and strong views as to whether FBARs are an effective tool in combating terrorism, money laundering, and drug trafficking, but the reality is that the requirement was developed specifically to address these concerns.

There are two perfectly good schools of thought on the question of removing the requirement to file FBARs for Americans abroad who would qualify for RBT. It boils down to: Do you think the FBAR filing requirement, which many in Congress believe to be aiding national security, combating terrorism and crime prevention, is not necessary for all Americans living abroad (regardless whether they opt into RBT)? Or, would you drop the requirement with respect to Americans living abroad that bring themselves within RBT?

ACA believes that, given Congress's heightened counter-terrorism efforts since 9/11, addressing FBAR in the context of RBT might create an obstacle to advancing RBT.

Congress might have serious reservations about removing any tool in its arsenal that addresses criminal and, in particular, terrorism financing.

At this early stage of working on RBT, ACA would prefer to not risk losing support for RBT in order to gain an exception from FBAR reporting. ACA believes it is better to push for the basic RBT proposal and possibly fold in an FBAR exception at a later time, after the Congress has embraced the concept of RBT. This should be possible, as FBAR is a separate subject which stands on its own.

Why include Same-Country Exemption (SCE) for FATCA reporting in RBT? Doesn't it automatically "go away" if RBT is adopted?

There are narrow situations where an American residing abroad might not be "covered" by RBT. Or, for special reasons, an individual might opt out of RBT. Or parts of RBT might be phased in over time. It's impossible to say at this stage whether a Same-Country Exemption might "come in handy".

By including SCE in RBT, it guarantees, without question, that it will be part of a residency-based approach to taxation. Moreover, ACA's advocacy calling for the implementation of SCE is a very simple thing, so why not do this? ACA's advocacy for SCE in no way diminishes our advocacy for RBT. We can and should ask for both. Finally, while the last Administration's Treasury Department did not embrace SCE, interested parties on both sides of the political aisle supported it, and the Taxpayer Advocate supported it. It is a good solution to lockout of Americans abroad from foreign financial institutions, albeit not a 100% comprehensive solution. It does address the heart of the issue; as to overseas Americans electing same-country treatment, their local bank can treat them, in effect, as inoculated from the burdensome FATCA rules.

Departure Fees, proof of tax compliancy, residency requirements: why should there be these requirements to opt into RBT?

Probably the one element of RBT that Congress will pay closest attention to is how easily can individuals abuse RBT for tax evasion purposes. It is for this reason that ACA has included in the “Vanilla” Approach elements that set forth the requirements for how individuals can qualify for RBT. Simply stating that one lives overseas and providing a foreign address would create an enormous loophole that Congress, we believe, would not accept. Loopholes generally result in causing negative revenue estimates to skyrocket, and they work against getting the serious attention of the tax-writing offices, potentially putting these offices off the topic of residency-based or territorial proposals now and long into the future.

A Departure Tax has been posited to ensure that individuals cannot easily find ways to “game” the system, running up the revenue costs of enacting RBT. For example, it would be a mistake to create an opportunity for an individual who holds highly appreciated assets to move abroad and then “cash out” and not pay any US tax. One of the defenses against this is a form of Departure Tax and a requirement that he/she logs some time as a non-US resident. As a subset, there is a problem with people jumping out of the regular tax system and then back in again.

Some form of Departure Tax may or may not be needed. Only a scoring of revenue costs will tell us for sure and, for that matter, what the right mechanics are for eligibility for RBT.

Why use District Economics Group (DEG) for the revenue estimating of RBT?

Outside of the government agencies that “score” or develop revenue estimates for legislation, there are few independent economic consulting firms that specialize in this work. The Big Four accounting firms provide revenue estimating for legislation. However, ACA believes that it is best to use a firm that is not involved in tax compliance and is, therefore, less likely to have conflicts.

ACA has selected District Economics Group because they specialize in tax policy services to develop and improve legislative and regulatory proposals. DEG has over 30 years of experience providing tax policy analysis to the Congress and Executive branches. They provide ground level insight into the federal revenue, legislative and regulatory process. DEG’s client base includes a wide range of industries, including non-profits. For more information on DEG, see: <http://districteconomics.com>.

ACA believes that DEG is best placed for working with us on revenue estimating for RBT. They are well-respected, independent, understand our project and our audience, and, most importantly, understand how legislation needs to be developed to promote passage by Congress. In addition, they have excellent access to the widest range of databases.

What about individuals who chose to stay with CBT or who can’t access RBT due to short-term or contractual employment? If FEIE and Foreign Tax credits are abolished will these individuals be double taxed?

ACA’s proposal first and foremost puts forth a road map for how to implement residency-based taxation. There would be no need for FEIE and Foreign Tax Credits for individuals who qualify for RBT as they would no longer, under RBT, be subject to US taxation.

For individuals who remain under CBT because of choice or due to short-term or contractual employment, ACA has posited several approaches. The goal is to place these individuals in no worse a position than under existing CBT rules. Under the “vanilla” approach, beginning any year including the year of enactment, individuals qualifying under existing residency rules (section 911(d)(1)) could elect section 911 treatment for up to 5 years, which period could not be extended. This is a one-time election and could not be revoked without the consent of the Secretary. Following this period, if individuals qualify for RBT treatment and wish to be taxed on a residency-basis, they could apply to the IRS for a Departure Certificate. This rule provides a transition rule.

What can be done to help individuals who for whatever reason are not able to or do not wish to elect RBT treatment?

A transition rule and special election are provided. Individuals can elect section 911 treatment to be applied to the taxable year of enactment plus three successive taxable years thereafter. These years reduce the number of years covered by the special one-time election for Short-Turn Overseas Employment (above). This gives individuals an opportunity to assess their situation and either place themselves under the RBT machine or not.