



## April 15: Tax Day in the USA: American Expats and new Tax Laws

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***Democrats Abroad Berlin received the following question from a CNN Correspondent in Berlin***

I hope you'll be able to help me. I was reading in yesterday's IHT how some US expats living and working abroad are finding their tax burden increasingly unbearable after changes to the US tax code two years ago. Also that some US companies operating abroad are tending now to hire locals rather than US expats because these tax code changes mean US hires are too expensive, thus affecting American competitiveness over here.

Would you be able to ask your members whether any of them are affected and if so, whether they'd be happy to talk to us about the issue? I've even read that some people are considering renouncing their US citizenship as a result!

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***The question was forwarded to our member Donald Black, who is a member of Democrats Abroad, an American lawyer and law instructor at the Free University of Berlin***

Each year, April 15th is tax day in the USA. All US citizens and Permanent Residents (Green Card Holders) are taxed on their world-wide income on April 15th whether they live in the USA or abroad. There are no offshore "tax havens" for natural persons who are US citizens or Permanent residents. Only aliens (foreigners) who are not Green Card holders can be excused from US Income Tax.

The original reason behind the world-wide tax obligation was to prevent millionaires from getting rich on the American economy (world's largest "free-market" economy) under conditions favorable to the accumulation of wealth, and then afterwards fleeing abroad to avoid US taxation on the wealth they had accumulated in the US economy. This was the original purpose.

The Congressional Joint Committee on Taxation ( <http://www.house.gov/jct/> ) oversees offshore taxation and conducts legislative hearings on offshore tax avoidance, while the IRS (executive branch) enforces offshore taxation and non-compliance.

In recent years, potential tax evaders have been targeted by dragnet data monitoring of offshore credit card purchases under the Offshore Credit Card Program (OCCP). The "OCCP is an initiative aimed at bringing back into compliance with U.S. tax laws participants who used "offshore" payment cards or other offshore financial arrangements to mask or shelter their income. The IRS used judicial John Doe summonses to request information from three credit card companies (VISA, MasterCard, and American Express) regarding individuals who may have participated in offshore credit card scams. The IRS also summoned information from a Florida credit card processor, Credomatic, that services banks located in Caribbean tax haven countries. The goal is to identify US persons from offshore card transactions. A vendor queries the data and compares it against Name Search Facility (NSF) and Information Return Master File (IRMF) data. If a Taxpayer Identification Number (TIN) is found, the data is sent in an Excel spreadsheet

through encrypted email to the Philadelphia campus, OCCP Unit. The spreadsheet is printed out and used by OCCP Unit personnel.

<http://www.irs.gov/privacy/article/0,,id=131233,00.html>

The data gathered showed a high incidence of non-compliance:

<http://query.nytimes.com/gst/fullpage.html?res=9C01E6D9123BF935A15750C0A9649C8B63>

I.R.S. Says Offshore Tax Evasion Is Widespread, by David Cay Johnston, March 26, 2002

There is a large number of bilateral tax treaties between the US and many developed countries <http://www.irs.gov/businesses/international/article/0,,id=96739,00.html> that have provisions for exchanging tax information about individuals. This is another source of information telling the IRS which Americans are working and paying taxes in which countries.

A nice overview article appeared in the NY Times:

[http://www.nytimes.com/2007/05/03/business/03tax.html?\\_r=2&oref=slogin&oref=slogin](http://www.nytimes.com/2007/05/03/business/03tax.html?_r=2&oref=slogin&oref=slogin)

I.R.S. Curtails Many Audits in Tax Havens, by Edmund L. Andrews, May 3, 2007

You asked if anyone was giving up his/her citizenship.

Well, US Citizenship is formally renounced abroad before a US Consul under Title 8, § 1481 <http://www.law.cornell.edu/uscode/8/1481.html>. Loss of nationality by native-born or naturalized citizen; voluntary action; burden of proof; presumptions.

One fellow who did this back in 1998 did it to avoid internet security restrictions; it was reported that "In 1996, the latest year for which data is available [then], 612 people lost their citizenship."

<http://online.offshore.com.ai/publicity/nyt-citizenship/>. The reason so few people do it is because there is a big tax penalty involved for well-heeled Americans. And this was sharpened in 2004:

[http://en.wikipedia.org/wiki/United\\_States\\_nationality\\_law](http://en.wikipedia.org/wiki/United_States_nationality_law)

"... a line of U.S. Supreme Court decisions ... limited the government's capacity to terminate citizenship ... [and] In the wake of administrative practice changes adopted by the U.S. Department of State during the mid 1990s, it is now virtually impossible to lose one's citizenship without expressly renouncing it before a U.S. consular officer.

There are also special provisions for persons who are deemed to have renounced citizenship for purposes of avoiding U.S. taxation ... Lastly, IRC section 877 ... was modified in 2004 ... [and now] establishes an objective test to determine if the section 877 [tax] regime will apply. If the former U.S. citizen fails one of these objective tests, for the following ten years after the individual's expatriation he or she will be subject to the 877 [tax] regime."

So, anyone who renounces US citizenship still owes back taxes, and will owe 10 years future taxes, if the person renouncing is well-heeled (e.g. two million worth of assets).

But, I think there is human interest story for you anyway.

First, the bi-lateral tax treaties are for international corporations and expressly exclude (via so-called "Savings Clause") flesh-and-blood natural person Americans from treaty benefits. However, most Americans living and working abroad still don't pay double taxes. That's because the Internal Revenue Code (IRC) grants a unilateral "exclusion" for "foreign earned income" under IRC section 911 (e.g. salary, wages, professional fees, business commissions). BUT this does not include "unearned income" (bank interest, rental income, stock dividends, capital gains, etc.) which are taxed as if received in the USA.

So, yes, US citizens are taxed on their world-wide income, but they get an exclusion for foreign earned income (see <http://www.irs.gov/pub/irs-pdf/i2555.pdf>), which in 2007 is US \$ 85,700. At the 1.58 exchange rate, that makes € 54,240.51.

BUT, this is for EARNED income, wages, salary, professional fess. It DOES NOT cover UNEARNED income: bank interest, capital gains, rental income, or foreign government subsidies (Arbeitslosengeld, Wohngeld, Kindergeld, etc.)

The Big Crunch now is that starting 2007 the left-over non-excludable income above 85,700 is taxed PROGRESSIVELY. So, if you look at the worksheet for 2007 on page 2 under <http://ftp.irs.gov/pub/irs-pdf/p4655.pdf> you will see that the left-over tax it is now progressive (!) beyond the exclusion amount (auf Deutsch = Progressionsvorbehalt) which means that the taxable portion is taxed as if the exclusion had been taxed, too.

So, the excluded earned income, is re-included, when calculating the non-excluded tax amount. This is new, and will result in higher overseas taxes making US managers abroad less competitive.

What this also means is that John Doe Average American will be paying higher tax on all his unearned income over and above the standard exemption and standard deduction amounts:

|   |                                |
|---|--------------------------------|
| 2007 Standard Deduction for Single (Form 1040, Line 40) ..... | \$ 5,350                       |
| 2007 Exemption for Single (Form 1040, Line 42) .....          | \$ 3,400                       |
|   | Total: \$ 8,750.00 With a 1.58 |

exchange rate for the Euro this means € 5,537.98.

And divided by 12 months = € 461.50.

Any American who receives unearned income (e.g. Arbeitslosengeld, Wohngeld, Kindergeld, bank interest, etc.) above this monthly amount will be taxed at the higher progressive rate in the USA. The foreign earned income exclusion does not apply to transfer benefits.

American citizens who are integrated in the German economy but receive transfer money, will eventually have to renounce their US citizenship or go hungry, if the dollar drops further.

So, this is your human interest story: US IRS taxes German minimum social welfare benefits.

The last statistic published by Berlin showed 12,735 Americans living in Berlin (2006). But this doesn't include the dual nationals, like Michael Steltzer's children. Michael thinks there may be about 20,000.

Historically, perhaps only 10% of the registered Americans filed for the IRS Form 2555 exclusion each year.

If only 25% were working, then 15% owe back taxes. And, the 2555 exclusion is a "use or lose" benefit. So, those who didn't file will have meanwhile lost the benefit.

Even if the US citizenship is renounced, the back taxes don't go away.

So, this story is going to become a big story for a lot of the 8 million or so Americans living and working abroad, especially in countries with liberal social benefits.

If you go to

[http://www.aca.ch/joomla/index.php?option=com\\_content&task=blogcategory&id=32&Itemid=46](http://www.aca.ch/joomla/index.php?option=com_content&task=blogcategory&id=32&Itemid=46)

you will see that the ACA in Geneva keeps up on the overseas tax issues.

Best Wishes,

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