United States - Bill Introduced to Modify Taxation of U.S. Citizens Living Overseas

On December 18, 2024, U.S. Representative Darin LaHood, a Republican from Illinois, introduced a bill that would implement a residence-based system of taxation for U.S. citizens living overseas and thus significantly modify the current system whereby all U.S. citizens are subject to U.S. income tax regardless of their country of residence. The draft bill is entitled the “Residence-Based Taxation of Americans Abroad Act.”[1]

WHY THIS MATTERS

The United States is one of two countries that imposes an income tax on worldwide income based on citizenship (the other is Eritrea). In a campaign message addressing U.S. citizens living abroad, President-elect Donald Trump pledged to end double taxation of U.S. citizens. The introduction of this bill represents a first step towards implementing this proposal, although passage of the bill is subject to uncertainty given that there are numerous other legislative proposals confronting the new Congress when it convenes in January 2025 and the Republican Party will have relatively small majorities in both the House of Representatives and the Senate.

This bill would provide significant relief for qualifying U.S. citizens living abroad in relation both to their U.S. tax liability and their information filing requirements.

Bill’s Proposals

Election to Be Treated as a Non-Resident

The bill establishes an elective process whereby a U.S. citizen living abroad can be treated as a U.S. non-resident for income tax purposes without having to renounce his or her U.S. citizenship. To qualify for the election, individuals would have to certify their compliance with all U.S. tax obligations for the five years prior to the election date and must pay the tax due (if any) under the departure tax rules described below.

U.S. citizens born outside the United States would be treated as “electing” individuals until such time as they establish residency in the United States.

The timing and other procedures for making the election (such as the required forms to be filed) would be determined by the Internal Revenue Service (IRS).

After making the election, taxpayers would be subject to U.S. tax only on their U.S.-sourced income and gains including income from the performance of services in the United States, income from ownership of a U.S. business, distributions from U.S. retirement and deferred compensation plans, and income from assets physically located in the U.S. (such as rent from real-estate investments).

Once the election is made, it would be effective for the current year and all future taxable years until terminated by the electing individual or if the individual again becomes a U.S. resident for U.S. income tax purposes under the existing residency rules. Individuals who make the election would be required to live abroad for at least three years from the election date, failing which the election would be reversed with retroactive effect.

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U.S. citizens going on long-term foreign assignments might benefit from making this election. However, they and their employers should be aware that the potential benefits would be lost if an assignment is terminated before the assignee has been outside the United States for at least three full years.

Benefits under Income Tax Treaties

Electing individuals would be entitled to claim the benefit of income tax treaties between the United States and their country of residence notwithstanding the fact that they would remain U.S. citizens. This would be accomplished by a provision in the bill that requires a waiver of the treaty saving clause in relation to electing individuals. Under a standard saving clause, the United States reserves the right to tax its citizens and residents as if the treaty were not in effect, with certain exceptions.

Exemption from Certain Reporting Requirements

The bill would provide electing individuals with an exemption from certain filing requirements, including Form 8938, *Statement of Specified Foreign Financial Assets*, Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, and FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* (the FBAR).

Certificate of Non-Residency for Foreign Financial Institutions

Electing individuals and any U.S. citizen born in a foreign country after the date of enactment of the bill would be permitted to apply to the IRS for a certificate of non-residency. The purpose of this provision would be to permit such individuals to establish that they are not “specified United States persons” for purposes of the *Foreign Account Tax Compliance Act* (FATCA). Hence, foreign financial institutions would not be required to undertake burdensome reporting requirements under FATCA, which frequently discourage those institutions from offering banking services to U.S. citizens living and working abroad.

Departure Tax for Certain High-Net-Worth Individuals

Electing individuals would be required to pay tax on a deemed sale of all their property as if it were sold for its fair market value on the day before the election. Certain property and income items would not be subject to this deemed sale rule, including deferred compensation items, specified tax deferred accounts (including section 529 qualified tuition plans, health savings accounts, etc.), interests in non-grantor trusts, real property located in the United States, and foreign real property that has been owned and used as the individual's principal residence for two of the prior five years.

Once the departure tax is paid, the individual's basis in each asset subject to tax would be stepped up to the fair market value at the date of the election.

The departure tax would not, however, apply to individuals who meet any of the following exceptions:

- Their net worth is less than the applicable estate tax exemption amount ($13.61 million for 2024, $13.99 million for 2025); or

- They are tax residents of a foreign country where they, normally or customarily lived for three of the past five years, and they certify that they have been in compliance with U.S. tax requirements for the three years prior to the bill's introduction; or

- They have not been a U.S. resident at any time since turning 25 years old or after March 28, 2010 (the date that FATCA was adopted) through the date of enactment of the bill.

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This departure tax has some similarities with the existing expatriation tax whereby individuals who renounce their U.S. citizenship and green card holders who terminate their green card status are treated as having sold their worldwide assets for their current fair market value and certain other rules. However, the proposed departure tax differs from the expatriation tax in several respects, including in particular that it would only apply to individuals with significantly higher net worth ($13.61 million as opposed to $2 million).

KPMG will continue to monitor the progress of this bill and any related proposals in relation to the taxation of U.S. citizens living abroad.

FOOTNOTE:

1 For the text of the draft bill, see *Residence-Based Taxation of Americans Abroad Act*.

See on the website for Congressman Darin LaHood (R-IL), "LaHood Introduces Bill to Modernize Tax System for Americans Living Overseas" (December 18, 2024).

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2025 Personal Tax Planning Guide

The "2025 Personal Tax Planning Guide" is now available. Written by a team of KPMG Washington National Tax professionals, the guide provides information and planning tips to help individuals and closely-held businessess make sense of the complex and ever-evolving array of U.S. federal tax rules affecting them.

Contact us

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