Donald Trump's Tax Cuts and Jobs Act: the expat American's perspective

By: David McKeegan, Co-founder, Greenback Expat Tax Services | 02 Jan 2018

Last month, as US taxpayers, tax experts and international businesses had long been anticipating, President Trump finally signed off on what had been billed as the most significant tax overhaul since the Tax Reform Act of 1986.

The Tax Cuts and Jobs Act (TCJA), which came into force yesterday, contains a number of important changes to the tax regime that currently affects most of the estimated 9 million Americans who live outside of the US.

As has been reported, the tax reform bill doesn't change a number of elements of the US tax code that many of these 9 million Americans have spent the last few months urging Washington lawmakers to deal with – such as the much-criticised US practice of taxing on the basis of its citizens' nationality, known as citizenship-based taxation or CBT, rather than on the basis of where they live, known as residence-based taxation or RBT. (Some, such as the Republicans Overseas, have been calling for "territorial taxation for individuals", or TTFI).

Less publicised but important to note, says David McKeegan, co-founder of Greenback Expat Tax Services, is that the Foreign Earned Income Exclusion (FEIE) and the Foreign Tax Credit were largely left intact by the tax code revision.

McKeegan, who calls these two elements of the US tax regime "the two most important provisions in the tax code for US citizens residing abroad to avoid or limit double taxation", points out that expat taxpayers will, though, see a slowing down of the rate of the increase in the amount they are able to exclude from their US tax bill beginning this year under the FEIE, due, he notes, to a change in how inflation will be calculated going forward under the new tax bill.

The FEIE will now be linked to the Chained Consumer Price index, which rises more slowly than the regular CPI.

As for the Foreign Tax Credit, which allows expats to obtain a dollar for dollar reduction in their US taxes, based on the amount of tax they paid during the year in question to a foreign government on income that is not US sourced, "for most individuals, there is not going to be any change", McKeegan says.

That said, there are some new elements to the US tax code that expats will definitely not be celebrating, McKeegan notes.

Below, he considers some of these and other important but thus-far-little-noticed clauses contained in the Tax Cuts and Jobs Act that are expected to affect many if not most US citizens who live abroad.

As I pointed out here in October, when I looked at where the Trump tax reform bill seemed to be heading at that point, your average American expatriate has to file a raft of documents in addition to their Federal Tax Return every year. And sadly – if unsurprisingly – the Republican Party's avowed determination to simplify tax reporting for Americans generally did not result in any changes to the currently burdensome, document-heavy reporting requirements now expected of Americans who live outside of the US.

As with any tax changes, there are winners and losers here. And I'm afraid US expats seem to be in the latter category with this 1,097-page-long offering from the Trump administration.

While US corporations outside of the US will no longer be subject to citizenship-based taxation, as a result of this legislation, there was no change for individual expat Americans living outside of the US – in spite of the strenuous lobbying efforts for much of 2017 by such groups as the American Citizens Abroad, the Republicans Overseas and the Democrats Abroad.

Such expats will continue to be subject to CBT, and to the Foreign Account Tax Compliance Act (FATCA), the 2010 law that boosted the US tax authority's ability to come after its expats for tax purposes.

As a result, I think it's safe to say that we will continue to see many US citizens who live abroad renouncing their US citizenships, possibly still in record-setting numbers, as has been the case in recent years.

Contrary to what some believe, this is not because they don't love the USA, or because they are greedy tax evaders, but because they simply can't afford the cost of compliance, which, as a result of FATCA, includes the inability to maintain bank and investment relationships abroad, and frequently, the need to pay tax to two governments on the same piece of income.

Indeed, it's fair to say that the Tax Cuts and Jobs Act doesn't really contain any positive changes for US expats. They will still be expected to file some or all of the following, depending on their individual circumstances, in addition to their annual tax return: an annual Report of Foreign Bank and Financial Accounts (FBAR/FINCEN114); a Statement of Foreign Financial Assets (Form 8938); an Information Return of US Persons with Respect to Certain Foreign Corporations (Form 5471); and a Return of US Persons with Respect to Certain Foreign Partnerships (Form 8865).

A few other negative impacts US expats should also be aware of:

- Expats, unlike homeland taxpayers, will not benefit from the reduced taxation of "passthrough" entities
- The Net Investment Income Tax (NIIT) – a 3.8% tax which often results in expatriate Americans being double-taxed, as they are not allowed to use the foreign tax credit to offset the NIIT – remains in place
- Expat Americans will no longer be able to deduct foreign real property taxes on their US taxes

'Territorial Taxation of Corporations provisions'

One of the most potentially hard-hitting changes for expatriates will be the the TCJA's Territorial Taxation of Corporations provisions. This is a big benefit for huge multinational corporations that have been "tax optimised" to reduce their US tax burden, but it is potentially problematic for those US expats who own small businesses that they incorporate locally – for example, a shop or a law firm operating in the United Kingdom, Italy or Singapore.

Under the new regime, any accumulated foreign earnings of these "Controlled Foreign Corporations" will now be deemed as having been repatriated to the US, and therefore taxed at a US federal tax rate of 15.5% for cash and cash equivalents, or at 8% for illiquid assets.

Such taxpayers can elect to pay this tax over an eight-year period, but it is still a new and certain-to-be controversial hit for such businesses, and the expats who own them: for example, an American who runs a shoe-repair shop in London, which is incorporated there – and, which is, let's say, is 100% compliant with its local tax obligations.

If this business retains US$50,000 in its corporate account to cover its operations during slower months, under the new tax bill, the IRS will tax this business 15.5% on these retained earnings, resulting in a tax of US$7,750 for its US expat owner.

If this expat owned Apple – the Cupertino, California-based computer giant – and his tax affairs had been comprehensively structured at considerable expense to retain its overseas assets in such a way as to avoid US tax, this new legislation would be seen as a benefit – he could now bring that money back to the US, and pay tax at a reduced rate of 15.5% not 39.6%, the former top corporate tax rate.

But our London-based shoe-repair shop owner will be out of luck in a big way. And given the way that the law has been written, he will have no time to structure his business in order to avoid the tax, as it will come into force immediately.

All of this basically means that US expats will not really benefit from Donald Trump's "unprecedented" tax reform, and some, such as those who own small foreign companies, will face new tax challenges.

In summary, then, the most important takeaway from the Tax Cuts and Jobs Act, as we see it (and this is not, I stress, because we ourselves are tax experts) is this: anyone who is an American citizen and who lives abroad should obtain expert advice on their particular circumstances, and do so well in advance of the tax filing deadline.

This is going to be a very confusing tax year, given the significant changes, and how late in the tax year they took place.

As in the past, expatriates automatically enjoy a two-month extension on this year's April 17 US filing deadline — that is, they have until June 15, 2018 to file their returns and other necessary documents, such as their FBARs. If you think you will owe taxes, though, it's always best to make an estimated payment as early as possible.

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Greenback Expat Tax Services is a multi-jurisdictional tax firm incorporated in Hong Kong, which specialises in the preparation of US taxes for Americans living abroad – as well as assisting advisers who need expert help with their American expat clients' tax needs – around the globe.

The above thoughts on the new US tax regime are intended as a general guide – not as advice, which should only be obtained from regulated advisers, nor as a statement of opinion.

More information on the tax code changes contained in the Tax Cuts and Jobs Act, and how they are likely to impact US citizens who live abroad, may be found in an overview on the Greenback Expat Tax Services website by clicking here.