



Issues in Citizenship-Based Taxation in the US & Beyond: The Transcript

Our panelists were:

- John Richardson, Lawyer, Citizenship Solutions, Toronto, Canada
- Dr. Karen Alpert, Finance Lecturer, University of Queensland Business School, Australia
- Leonard Tuber, Partner, International Tax Help, Israel

Opening Remarks

John Richardson: My name is John Richardson, I live in Canada, I'm a Toronto-based lawyer and very quickly if I could ask Leonard and Karen to introduce themselves.

Leonard Tuber: My name is Leonard Tuber and I am a tax manager in Israel for a firm that is called Aboulafia. We're an international tax firm; we do of course Israeli taxation and auditing, but also US, UK and French taxation. I'm licensed as an Enrolled Agent but I have a degree in accounting from a US university. I've been practicing my entire professional career in Israel. I came to Israel as a teenager, went back to school to go to college, then came back here and started practicing almost after graduating school. So I have an EA credential and I have been working in international taxation my entire career here in Israel.

John: I think it might be a good moment before we ask Karen to introduce herself, one of the issues here with compliance is, of course, who does a prospective client approach. Can you briefly explain the difference in a little greater clarity between an Enrolled Agent and a CPA?

Leonard: An Enrolled Agent, our credentials come directly from the IRS as opposed to a state-accrediting agency such as the New York State Board of Certified Public Accountants. We have the same unrestricted practice rights in the area of taxation as a CPA; however, we cannot audit financial statements. But we can represent taxpayers in front of every department within the IRS. It's a very good accreditation for international practitioners because we're not limited to a state.

John: Interesting. Since we've gone this far in the discussion, could you explain to our listeners what Circular 230 is and how, in a sense, it provides a regulatory framework for you?

Leonard: Circular 230 is basically the ethical standards by which tax practitioners have to abide by. I believe that'd be the best general description of Circular 230, that's essentially it. As practitioners, we don't only have certain legal but also ethical responsibilities, and Circular 230 does the best that it can to define what those are. And all EAs, CPAs, anyone engaged in US tax preparation are of course bound to Circular 230.

John: Would that include a base tax preparer?

Leonard: I believe that any federal authorized tax preparer, and there are different levels today, are bound by Circular 230.

John: As well as introducing yourself, Karen, you either are or at one time were an active CPA.

Karen Alpert: At one time, I was. So when I finished my Master's degree, I went to work at one of the big firms as a tax professional and worked my way up to tax manager and then left to go on to other pursuits. I have a background in tax. I did get a Master's in Tax at the University of Southern California back in the 1980s when I was doing tax. It's been 30 years now since I was an active tax preparer but I

do have a bit of a background in that part of the law. In 1995, we moved to Australia so I have been in Australia since. It was not feasible for me to resurrect my CPA so I went the academic route once I got to Australia. Got a PhD in Finance from the University of Queensland, which is where I am currently a lecturer in finance. My research covers the tax effects of all sorts of things in finance and recently I have been spending some time looking at citizen-based taxation and how it affects US expats especially in Australia.

John: And doing a fabulous job of that as well, I might add. A great contribution to this discussion.

If we look at the issue of whom somebody might go to, to get taxes done. We have lawyers, I'm a lawyer but I wouldn't go to a lawyer to get your taxes done, period. We have an EA, which Leonard would be an example of. We have the CPAs for whom tax is one sort of specialty, which Karen either was or is or whatever. I'm going to use the H&R Block type; these are tax preparers. They would perhaps pass a test administered by H&R Block but they wouldn't have any sort of independent validation or something like that. And all of these people when you approach them come with certain rules that they have to abide by like the Circular 230.

Karen, a moment ago you said that you'd been spending a lot of time researching in relation to citizenship-based taxation. I noticed that the title of this webinar is Citizenship-Based Taxation, and personally I think that's a bad description of what's going on here. I think we might want to start with what are we actually talking about here. Karen, is citizenship-based taxation a very descriptive way of describing what we're here to talk about today



Question 1: Is citizenship-based taxation a very descriptive way of describing what we're here to talk about today?

Karen: Well, it's really more the taxation of citizens who are not living in your country because the US taxes residents regardless of their citizenship. But it's only the citizens who live outside of the country

that it claims the jurisdiction to tax solely because of their citizenship, even though they are tax residents elsewhere.

John: So would you say then that a more accurate description would be non-resident taxation rather than citizenship taxation?

Karen: Worldwide taxation of non-residents. In other words, taxing not just based on source, just about every country will tax non-residents on income sourced within that country. The US will do the same whether you're a citizen or not. The question is what the US does with your non-US sourced income when you're not a US resident.

John: So, Leonard, would you then agree with this: what we're really talking about here is the rather unique US practice of imposing worldwide taxation according to US tax rules on people who are actually tax residents of other countries?

Leonard: Yes, I would agree with that description, yes.

John: Do you think that's a better description than just citizenship-based taxation?

Leonard: Well, one, you would have to be a citizen of the US to be subject to worldwide taxation, that'd be the first qualification. When you go beyond that, of course, you have the issues of the US taxing its citizens who reside and are tax residents outside of the US on foreign sourced income, which many countries do not even tax. Israel, up until very recently at least in historical terms, did not always tax its residents on income generated outside of Israel. It's a full inclusive tax system, the US will tax its residents regardless of where they live on income from all sources, taking into account certain mechanisms under both domestic tax law and treaty to try to mitigate double taxation.

John: So to give a very visual example: what we're talking about here today, let's take someone from Israel or Australia who was born in the US, and we'll start from the premise that they are already living in Australia or Israel and paying tax according to US tax rules in Israel. And their income earned in Israel is subject to direct taxation by the US, even though they do not live in the US. Have we got that right?

There are a lot of people in the world who don't seem to understand the problem of the US imposing worldwide taxation on people who don't live in the US. Of course, they haven't experienced CFC rules, PFIC, phantom capital gains and what over the last ten years, in my view, has simply become escalating examples of what I'm going to call fake income or income that's taxed without any kind of realization event.

Leonard: I agree with you. Income that has not been constructively received and sort of the fundamental principle of at least domestic tax law in the US is that income is taxed when it's constructively received. When you look at the anti-deferral regime that affect US citizens living outside the US, the PFIC regimes that you mentioned, Subpart F income, the various CFC regimes, they are taxing income at the individual level, which is not constructively received, which in my mind is a very big departure from one of the very fundamental premises of the equitability of US taxation. You can tell from that, someone hasn't received, hasn't brought it into their pocket, it's overreaching, that's subject to debate, but what we've seen in the past decade has been a very far reaching attempt to just immediately repatriate income into the US tax system.

Karen: I find the term 'repatriate' kind of amusing when you think about somebody living in Australia all their life and they're going to repatriate their income to the US?

Leonard: That's why they call it 965 Repatriation Tax, I was kind of borrowing the term here.

John: Maybe by using the word 'repatriate' they're making it seem patriotic. One of the problems with these abstract discussions is that it obscures what's going on. Isn't it a better way to put it: that what these rules do is make up income a person never receives that are sourced to another country and simply steal that money out of the country?

Question 2: What these rules do is make up income a person never receives that are sourced to another country and simply steal that money out of the country?

Leonard: Well, there are some adjectives that you used in there that I don't know if I would use. I mean stealing income; I don't know if it's stealing income. I do think that one does have to have a legal right to income. I mean you definitely have to be the shareholder of the CFC, you have to be the beneficial owner of that income. They are timing differences. Once you agree with the general principle of citizenship-based taxation, and that's for another discussion, then the question becomes whether income recognition can be deferred and I certainly think the US has gone to extremes in that respect as far as when they have the right to tax income. In the US, for instance, under the normal corporate structure, someone owns a corporation, the individual is not taxed until there's a distribution, until that income has been constructively received, distributed out of the company and into the individual taxpayer's pocket. Today that is not the case.

Karen: For active business income, that's how it was with CFCs even before the Tax Cuts and Jobs Act of 2017, right?

Leonard: Under Subpart F, yes, but that generally only targeted passive sorts of income. Now under GILTI they're going after active business income, taking things to extremes here.

Karen: So it's impossible to run a business as a US expat now.

Leonard: It's becoming much more difficult, even for accountants that have their own corporations, yes.

Karen: So what that does then is, if you cannot run your business, you cannot hire any employees, it is the Israeli economy that hurts, not the US economy. So these US tax rules are affecting the host economies.

Leonard: Certainly, it's very difficult for Americans living in Israel and I'm sure in other countries, what's the best entity in which to do business in Israel? For instance, there's a double-edged sword here, if you're self-employed in Israel, you're subject to self-employment tax in the US.

John: That's a great point you raise. Can I get you to pause there and elaborate on that at this moment? One of the things that I find interest, you know, my world is more Canada and perhaps the UK, but I'm aware that Israel does not have a totalization agreement. Is that correct?

Leonard: That is correct.

John: And that's a problem exactly why? Compare the situation for a self-employed individual in Canada that does have a totalization agreement or Australia, which has one too, and your country Israel, which does not have one. Why does this exacerbate the problem?



Question 3: Compare the situation for a self-employed individual in Canada that does have a totalization agreement or Australia, which has one too, and your country Israel, which does not have one. Why does this exacerbate the problem?

Leonard: Self-employment income is essentially social security. If you're a self-employed individual, you're paying both the employer and the employee portion of social security, money that you put away for your retirement. If you're living in Switzerland, Canada or Australia, you're subject to the social security system within your country. Totalization agreements say that if you pay into the social security system in the country in which you're resident, you do not have to pay into the US tax system. You don't pay self-employment tax.

John: What's the percentage rate of the self-employment tax?

Leonard: 13.5 percent, currently. Now, let's say you're a sole proprietor here in Israel; you're an accountant, you didn't incorporate, you work for yourself. You put out a shingle and work for yourself. Your income can be excluded under the foreign earned income exclusion or by the utilization of foreign tax credits. So you're not paying income tax to the US but there's a separate layer of tax called the social security tax, the self-employment tax, which you do have to pay and is not

eligible to be offset by the self-employment tax you pay in Israel or by any foreign tax credit. So you're paying into a social security system that you may never receive those benefits. So, in the past, a very simple planning technique was telling people to incorporate and you'd simply take out a salary out of your own company. If you're a salaried employee, you're not subject to self-employment tax. But now, of course, under GILTI, they're going to tax your corporate earnings so there's really very few things, if any, that a US citizen can do in Israel to effectively do business. If they're self-employed, they have to pay self-employment tax. And if they operate under a corporate entity, they essentially have to drain somehow currently under GILTI all of the income from the corporation or they are going to be taxed before they actually receive money in their pocket. Israel is not going to impose a tax on corporate earnings that have not been distributed, so you now have a tax liability to the US without any offsetting foreign tax credits and it's just a mess. It does result in literally double taxation, I believe.

John: So the message for an American citizen in Israel would be something like a bumper sticker that says: "I'm American, I'm Not Self-Employed."

That was a very interesting answer and provides a segue into one of the questions which had to do with the foreign earned income exclusion and foreign tax credit regimes and this sort of stuff.

Karen, could you discuss the foreign earned income exclusion but with an emphasis on the following slant: there's a perception in the US, particularly, that the way the foreign earned income exclusion allows an American citizens to simply exclude 100 thousand dollars of income per year, so what's the problem exactly?

Question 4: Could you discuss the foreign earned income exclusion, emphasizing the perception in the US that the foreign earned income exclusion allows American citizens to simply exclude \$100 thousand of income per year? What's the problem exactly?

Karen: The problem is that not all of your income is earned. The foreign earned income exclusion is only good for earned income. So if you're living in Australia or wherever while you're employed, no problem, you have a foreign earned income exclusion. But at some point you're going to retire and when you retire your income is going to be not earned because you're not earning anything anymore. So the foreign earned income exclusion completely evaporates for unearned income, number one.

In Australia, I think very few people use the foreign earned income exclusion because, unless your income is between 12 and 20 thousand, you might find the foreign earned income exclusion useful because you're hardly paying any Australian tax at that level. But once you get above 20, 25 thousand, you'd be paying more in Australian tax than you'd be paying in US tax, so the foreign tax credit works better because with that you're allowed to carry the credits forward for ten years. And specially if you're nearing retirement, those credits might possibly—depending on how your retirement income comes out, what FTC category it's in—allow you to offset some of the US tax on your retirement income after you retire. The foreign earned income exclusion does not fix everything because not all income is earned.

John: So it applies only to earned income and, without getting overly technical, earned income should be thought of as salary, employment income and gross income from self-employment.

Now, you both point out that one could, in limited circumstances, use the foreign earned income exclusion and that's an exclusion, it's though as there's no income to tax period. But let's now extend this over to the foreign tax credit rules because those need to be seen a little bit differently. You do owe US tax because the income is included, it's just that the mechanism used to pay the US tax is tax you pay on that income in another country. Would you agree with that definition?



Question 5: Let's now extend this over to the foreign tax credit rules because those need to be seen a little bit differently. You do owe US tax because the income is included; it's just that the mechanism used to pay the US tax is tax you pay on that income in another country. Would you agree with that definition?

Leonard: Yes, you can offset your US tax liability by tax paid within your country of tax residency. So if you owe 100 dollars of US tax but you paid 100 dollars of tax on the same category of income in your country of residency, then you end up having a 0 tax liability. It remedies double taxation.

John: And possibly the excess can be carried forward for ten years, is it?

Leonard: Yes, the excess can be carried forward. However, with GILTI they've created a separate foreign tax basket, so you cannot offset any tax; whatever you've put within your GILTI foreign tax basket cannot be used to offset earned income or passive income as well.

John: There's no carry over of that either, right?

Leonard: I don't believe so but one would have to make an election, a 962 election. A problem is how does an individual get an indirect foreign tax credit, which could be a subject for another webinar.

John: So this is interesting because someone from another planet or someone from the US living in the US, I don't mean they're the same, I mean someone who had no real first hand experience of the effect of this type of stuff, might say, "How can there be a problem? You've just explained how people living outside the US are unlikely to pay any US tax, they remove it with the foreign earned income exclusion, if they cannot do that they can use foreign tax credits."

Karen: That's fine if you have a very simple life, you're working for an employer, you're not saving for retirement, you're just living hand to mouth, week to week, then it's no problem. The minute you try to start saving for your retirement, run a business, investing, any of those things, then you run into problems.

John: And that's without even considering the whole anti-deferral problems, right? Actually, before we leave the whole foreign tax credit thing, am I right or wrong when I say that under the Internal Revenue Code that the Obama 3.8 percent healthcare tax cannot be offset with foreign tax credits?

Leonard: You're correct. And I have seen how that has destroyed savings for people here in Israel. Dividends that people have taken on investment, incomes that they then want to reinvest for their retirement, for their savings, gone. Paying 3.8 percent on that and it cannot be offset by any foreign tax credits; it's a redistribution of wealth that I think we have not seen historically in decades.

Karen: The US stealing out of other economies.

John: But Leonard doesn't like that word, you're warming up to the word now, so far, the word stealing, maybe.

Leonard: Let me put it this way, I definitely think they're overreaching; it's certainly overreaching, especially with the self-employment tax. How many people living their entire lives outside the US are ever going to be recipients of Medicaid or anything like that?

John: It is quite extraordinary that this thing is set up so that people in other countries are actually funding healthcare for home landers that they themselves cannot take advantage of. It's not a bad idea, I mean, maybe other countries should take the example of the US and let residents of other countries fund your healthcare system.

Leonard: Before we leave the foreign tax credit discussion, when we're dealing with investment income such as long-term capital gains, qualified dividends, the actual preferable tax treatment that is meant to encourage people to save money for their retirement, much of that under, for instance, the foreign tax rules. When you take into account the long-term capital gains rate differential adjustments, just the math involved in calculating your foreign tax credit, a very big percentage of your foreign passive income isn't even eligible for tax credits to begin with.

John: Now that's a very important point and if I can just pause here and generalize that a bit. One of the ongoing problems is that there are plenty of taxes that people pay in their country of residence that because they do not meet the definition of that kind of US income cannot be used to offset, as a tax credit, a US tax. You see this all the time.

It's pretty clear just from this roundtable that we've been having that anybody who makes the claim that somehow the foreign earned income exclusion and foreign tax credits rules solve the problems of Americans abroad really doesn't have a clue what they are talking about. Would you agree?

Leonard: I would certainly agree with that statement.

John: So anybody from the US who's listening, there's your proof. I think this is a gigantic problem in trying to get these laws changed; it's so complicated. Both of you are superstars in this area, but one of prerequisites to be a superstar in this area is to spend an ungodly number of years thinking about this stuff. Do you agree?

It's not the kind of thing, there's no time to really learn it. So we have this problem, even if the income is actually realized, and now we have this whole layer of what I think of as fake income, which flows from the anti-deferral regime. And I would argue that even the PFIC rules are fake income because of redistributing the income over years, the income was never received. That's fake income.

Karen: Add to that to the currency fluctuation income. My life is in Australian dollars, when I was doing US returns I had to do them in US dollars, as if everything I bought was in US dollars.

John: Just last week I was working with somebody and he thought he had a 200 thousand dollar capital loss that turned out on the US return he had a gain. Never seen an example as egregious as that but it shows you how these exchange rate shifts can create real problems.

Leonard: That's a really interesting example. I saw an example of that this week. As bad as that. Due to exchange rate differences, someone who had a loss here in Israel on the sale of property ended up having a US capital gain.

John: An American who leaves the US is tied to the US dollar.

Karen: To add to that currency thing, the whole thing of mortgage indebtedness with the currency shift. When you think about it economically, you buy a house; you put a mortgage on it. If you're working in US dollars, that's a natural hedge. But the US denies you the loss of the loss side of the hedge and it recognizes the income on the income side of the hedge.

John: The more I learn about this and I think we would all agree that we're all permanent students of this. This is not something where you take a course and in 30 days you know all this stuff. We're all permanent students. And one of the reasons we're permanent students is, we've been having this discussion about the Internal Revenue Code, we now have these treaty overlays. One of the things I would like to talk about in relation to the treaties, which will provide a nice segue into other things, is this business of the savings clause. Karen, would you like to tell us what the savings clause is and why it's a problem? And how perhaps changes in the tax treaty can be of help?

Question 6: Would you like to tell us what the savings clause is and why it's a problem? And how perhaps changes in the tax treaty can be of help?

Karen: So the savings clause says—the US inserts this in every treaty it writes—that if you're a US citizen the treaty doesn't count except for these really small lists of enumerated sections in the treaty that you can use as a US citizen.

John: Does it help for the double taxation?

Karen: No, it doesn't.

John: I agree with you, I think that's the right answer. I haven't looked at all of these but if you look at the US-Canada one it says that they provide tax relief from double taxation I think to the extent that US law allows it.

Karen: Usually, the no-double taxation article of the treaty is one of the things that is exempted from the savings clause. Even so, there are a lot of things that you cannot use. In the Australia treaty, the whole pensions article, the only thing you can use is the social security clause in that article. The rest of it, if you're a US citizen, you cannot use.

John: Of course, in Australia, the situation is absolutely horrendous. We've talked about this many times, the whole issue of the superannuation and the US tax status. And this really illustrates how different these treaties actually are. Canada, thank God, and the UK have fairly robust treaties that provide a much broader definition of pensions.

Karen: I think it was malpractice from the part of the Australian government because the last protocol was signed in 2001 and superannuation came on in 1992, so really they should have put a clause to protect.

John: You know what the problem really is here? I do not believe when these treaties were negotiated that these other countries understood that by agreeing to the savings clause what they were really doing was agreeing to allow the US to impose worldwide taxation on their own residents.

Karen: I think also when they first put the savings clauses into the treaties that would have been around the 1930s, citizenship was completely different. You were a citizen of one country and one country only. Dual citizenship was very rare back then. And so maybe Australia or whoever, when they put it in said, "Well, if you come over here and live here but don't take up our citizenship, let the US do whatever they want with you, you're still a US citizen." But the world is not that way anymore; more and more people are dual citizens and the treaties haven't moved on with the times.

John: That's absolutely right and some provide far better protection than others, there's no doubt about that. Now, of course, what is really exacerbating this problem is the whole FATCA thing, where the IRS has deputized non-US banks to essentially hunt people with US indicia and then I guess they are free to decide what to do after they are identified. But do you think moving forward countries are willing to put up with this anymore, the savings clause in the treaty and some of this other garbage?



Question 7: Do you think moving forward countries are willing to put up with the savings clause in the treaty and some of this other garbage?

Karen: I think they should add a citizenship tiebreaker clause to recognize that there are dual citizens and, if you're an Australian citizen living in Australia or an Israel citizen living in Israel, then you should be able to use that tiebreaker clause to break US tax residence.

John: As a further exception to the ongoing savings clause? What are your thoughts on that, Leonard?

Leonard: That's a very interesting thought, to have a tiebreaker clause basically to determine where your tax home is. But, then again, the US would be doing away with the worldwide taxation to begin with if it were to do that. Why would it end just to treaty articles that are subject to the savings clause? And I just don't see the US, at least currently, being willing to consider that.

John: I'm not sure that's true. I've thought a lot about this. And I'm not sure my thoughts on this are always right or rational. But it seems to me that the savings clause in the treaty gets the agreement from the other country that it's ok for the US to impose taxation on these people. So you get rid of the savings clause or at least not apply it to the group we're talking about, the US is still perfectly free to keep its existing Internal Revenue Code and people can comply or not comply. I think we would agree here that the stats strongly suggests that the vast majority of US citizens abroad are not filing their taxes, I think.

Leonard: Well, in Israel that certainly isn't the case because Israeli banks have become the enforcement arm of the IRS and Israelis cannot open a bank account now without making a declaration that they are not US citizens. Everyday I'm writing letters to banks telling them that this individual is compliant with their US tax obligations, so in Israel it's very difficult. If you want to use a

commercial bank in Israel and you're a US citizen, and unless you want to lie when you open a bank account with the ramifications of that here in Israel, you're going to be compliant. Israel is a country where FATCA has forced compliance for most US citizens living here.

Karen: In Australia, they will ask you for your Social Security number but they don't care whether you're compliant or not. The banks don't ask about your compliance, they just want your Social Security number, and then once they have your Social Security number, it's up to you whether you comply or not.

Leonar: In Israel, the major Israeli banks, for instance, Bank Leumi, they have all entered non-prosecution agreements with the US government, Bank Mizrahi-Tefahot, Bank Hapoalim, they are currently negotiating non-prosecution agreements. So banks here pretty much have to identify their US citizens unlike in Australia, I would imagine. The banks here are under a lot of scrutiny, so compliance is pretty much mandatory for any American who wants to use any sort of commercial bank in Israel. I opened an account recently and they asked me to send them copies of my FBARs that I file, so it got to the extent where I'm turning over my own tax and informational returns just to open up a bank account.

John: Why in God's name would anyone not renounce US citizenship in this environment? Are most of these people in Israel dual citizens?

Question 8: Why would anyone not renounce US citizenship in this environment?

Leonard: Yes, most people are dual citizens and many have renounced US citizenship. I think it has more to do with the emotional issue; people want the security of the US passport.

John: They want the security of a passport that is destroying their lives.

Leonard: Again, it's an emotional decision; everybody looks at things differently. But it is more difficult to be a US citizen today living in Israel and many of my clients, now former clients, have expatriated, they've given up their US citizenship.

John: In the years I've been working on this problem, I think that unless—US citizenship is a disability if you live outside the US—you want to live your life with a disability, I think people need to get out of it. I find it incredible that somehow they are not living in the US, they are citizens of the country they are living in, I would have to think that the people who are not renouncing are the people who can use things like the foreign earned income exclusion to shield all their income, I don't know, it baffles me. There are a lot of people from my perspective in Canada, and I've been seeing a lot of this lately, who I think absolutely have to renounce to protect their ability to survive in their old age.

Here's an example. Let's say you have a US citizen married to a non-citizen and different countries have their own sort of tax systems and work in different ways, the principle of residence is a form of retirement savings. You have these people in their sixties and they're married to a non-citizen. If that non-citizen were to die, they'd inherit all this stuff and they would become a covered expatriate. They cannot renounce then without paying an exit tax and they may have to renounce because, let's say, you have somebody living in a big expensive house and one spouse dies, without the income of that spouse they no longer have the money to pay for the upkeep of the house, so they have to sell the

house, but then the house is subject to a massive capital gains tax. I think these people have to get out just to protect themselves, I really do.

We had a lot of questions coming from people, which I'm going to redefine loosely as the role of tax compliance industry and the professional advisors and the enforcement of US citizenship-based taxation. Generally, the questions revolved around: What should individual tax, compliance or life consultants, what kind of advice should they be giving somebody who's a US citizen who learns all of a sudden, that horrible moment where, "Oh my God, I thought I've been tax compliant my whole life and now I have this problem." So what they do is they call an accountant, I'm sure you get these calls, Leonard. What do you tell someone like that?



Question 9: What kind of advice should individual tax, compliance or life consultants be giving to somebody who's a US citizen who learns all of a sudden: "Oh my God, I thought I've been tax compliant my whole life and now I have this problem." What do you tell someone like that?

Leonard: Again, we're all subject to Circular 230 so I'm limited in what I can tell them. Obviously, we do our best within the rules of the Internal Revenue Code if possible to shelter income from at least current taxation, and we inform people that they can give up their US citizenship and what that would involve. That's all that we really can do.

John: You tell them that you're limited in what you can say to them. Do you tell them, "Thanks for coming in, before we start I have to tell you that I'm subject to the limitations of Circular 230, therefore the advice I'm giving you has to be limited to such and such a thing." Do you add that?

Leonard: I think it's understood that the advice I'm giving them is legal tax advice. I'm not going to tell an American citizen living in Israel not to pay their taxes.

John: You cannot do that. I agree with you completely. But can you tell them that you cannot tell them anything other than what you're telling them? This came in in five or six questions.

Leonard: They are coming in for US tax advice, I tell them that I'm certainly sympathetic with them; I'm very much in the same boat, even though I'm an accountant. I live and work and make my living outside the US, I have to worry about 965, GILTI, how my pension fund can be characterized by the US as to whether they are trusts or other things that can be considered PFICs, I tell them I'm certainly sympathetic of them, we're on the same boat, and I will do whatever I can, within my understanding of the rules of the Internal Revenue Code, to limit their tax liability to the US to the biggest extent possible. And that's pretty much what they are expecting to hear from me when they come to me.

Karen: I get emails, I got one today: "My son was born in the US and he wants to buy a medical practice." I tell them to read before they go to an accountant. Give them some references, go read, make sure you know what you're getting into before you go to an accountant because once you go to a US tax preparer, they are going to prepare tax returns for you.

Leonard: Well, you know, I guess tax attorneys might have a little bit more leverage than accountants, I don't know for sure.

John: It's a very interesting question. Let's say, you look at lawyers, for example, what about the situation of, say, an Israeli lawyer in Israel, not a member of a US state bar, I'm not pretending I know the answer to this question, but it would seem to me that if someone went to an Israeli lawyer in Israel that it would be reasonable for that lawyer to say, "Well, there's nothing in Israeli law that requires compliance with this, it's a matter of US law." Would you go that far with it or do you think the savings clause in the treaty should be interpreted to mean that there is something about Israeli or Australian law that requires US tax compliance?

Leonard: I'm not sure I know the answer to your question. There is something within the Israeli tax ordinance that says one is not allowed to advise someone to evade taxation in another country as well. That is something very particular to the Israeli tax ordinance. Many people, specially those we call US citizens by accident, they go to a bank and they are now forced to sign a W9, their parents have been living in Israeli for 70 years, they don't consider themselves Americans, they first go to an Israeli attorney and in most cases they are referred to a US tax attorney living. That's generally what's happening in Israel.

John: This is a gigantic problem. And then we extend this over to those people who are dual license, both Canada and the US, both Israel and the US. I wonder if there are conflicting ethical obligations here. I don't know. I don't believe there's anything in Canada, which would speak to compliance with foreign tax laws. I believe there's in the UK, so this is another problem.

Leonard: Now the entire banking industry in Israel someone has to show that they are compliant with foreign tax laws. So this is something Israeli attorneys are very sensitive to. I think that maybe in the old days when FATCA first came around, there were lawyers giving whatever advice they gave. But today I'd be surprised if I heard of an attorney in Israel, dual license or not, that would advise someone not to comply with foreign tax rules.

John: I don't think you'd ever get anybody to advise somebody not to comply, I think that's a foregone conclusion. But it does seem to me that that's a different issue from the simple statement, "Well, depending on what country you're in, this is a US law and does not apply here, nobody in this country is going to force compliance, should that be the case." I think this is a terrible problem and is the thrust of a lot of the questions that came in for this webinar. What they are really asking is: Can you clarify the role that professionals are playing in enforcing these extraterritorial US tax laws? I think the answer you're giving me is that it's a pretty big role.

Leonard: Well, we're definitely preparing tax returns. Anyone who walks in my office, they may feel like they are being compelled because the bank, they have to show they are compliant in the US to open a bank account and stuff. Obviously, if you're a US tax accountant working in a foreign country, you're subject to the rules.

John: What's your thought on this in Australia? Once again, I think, not that I'm suggesting that there's a definite answer to these questions other than the answer that EAs and CPAs have to comply with Circular 230, we can see that the answers sort of shift depending on where you are. Karen, what's your perception of what's going on in Australia?

Karen: I'm not sure I can answer your question about the legal obligations of an Australian attorney. But I encourage people to try to learn to do as much as they can themselves to the extent that they can. Some people's stuff is way too complex.

John: Do you think that the value of staying away from lawyers and accountants is enough to keep people's lives simple? If I do this I'm going to need an accountant or lawyer and that's the last person I want to be involved with so I won't set up this business.

Karen: I still think there's a fair number here in Australia who're not compliant. For those who are not compliant, they're blissfully unaware a lot of them of the whole thing. So their bank asked them for their Social Security number? Nobody is forcing them to comply and for some it would be catastrophic to try to comply.

John: Oh my God, it would wipe them out. Think of all the people; basically think of themselves as Australians or Canadians or something. In Canada, small business corporations operate as private pension plans, so for them to get involved in this means they have to essentially liquidate their pension plans to comply with this.

Karen: You get someone who has a self-managed super fund over here and most tax professionals will treat it as a grantor trust. We'll write straight through it, what have you invested in, and these things may have been built up, SMSFs can have up to four members, you got four members and two of them are near retirement age usually, so you have big bucks inside the SMSF and it becomes a real nightmare.

Leonard: The compliance for those funds I can imagine is very difficult and expensive even if someone wanted to comply. 25-30 filing requirements, certainly trusts are subject to PFIC rules. One of the things we do in our firm with the very Israeli type of pension arrangements is to look at it and really make sure it meets the federal entity rules as to what is a trust, we want to bring it out of PFIC world as much as we can. That's a big part of what we try to do here.

John: You make a very important point, Leonard. For people who're watching us, just because something is called a trust in Australia or Canada, it doesn't make it a trust under the US tax law. So the first step is to think about and consider what the proper categorization of this thing would be for

US tax purposes, because that could make a difference. My impression looking at this stuff is that a lot of people say, "I see the word trust in Australia or Canada so therefore it's a trust." Nobody is stopping you from treating it that way but treating it that way brings along all kinds of expensive and bureaucratic apparatus. It's a very big problem.

I think there's a lot to be said for Karen's suggestion of the DIY type of thing. We all are professionals in some way or another, but I think that professionals can be extremely dangerous for Americans abroad, unfortunately, precisely because of these rules.

I think all of us would agree because we've been on the frontlines of carnage here that these are very bad laws. Nobody would disagree with that, right? They are unjust, they are immoral, they are basically imposing not only taxation but a lifestyle based on nothing but place of birth, there are many people who cannot afford to comply or renounce because of the prospects of these exit taxes.

Would you support the end of this citizenship-based taxation regime? Do you think the world would be better?

Question 10: Would you support the end of this citizenship-based taxation regime? Do you think the world would be better?

Leonard: Yes, I think that a more equitable tax system would be residency-based taxation and, of course, being taxed if you live in Israel but you have income-producing assets in the US, then of course the US or any country would have the right to tax income that is generated within its borders such as with real estate. But, yes, I would support moving away from simply citizenship-based taxation that simply your citizenship is enough to bring you into the tax jurisdiction.

John: I don't know how familiar you're with the holding bill, which is in its early stages. Does that end citizenship-based taxation?

Karen: It moves more towards a residence-based system but the US is still asserting jurisdiction over all citizens everywhere. They are just saying if you live in a foreign country, you can file once a year with a simple little form that says you live elsewhere and they will only tax your US source income and not your foreign source income. So it's basically the foreign earned income exclusion extended to all foreign income. But you're still subject to estate tax, gift tax, there's nothing explicitly in the bill that takes away FBAR or any of the other information returns that are supposed to be filed even if you're not supposed to file a tax return.

Leonard: There are a lot of internal contradictions in that estate tax. Basically, if I understand this bill correctly, it would be treating a US citizen living in a foreign country as if they were non-resident aliens, taxing them only on US sourced income, but when it comes to estate taxes, they'd still be subject to estate taxes even though they are not domiciled in the US. Any type of remedy is going to be wrought with internal contradictions.

Karen: There are also the transition rules in there, where any foreign assets that you own are still taxable when you sell them, the capital gains. How they are going to police that, I have no idea.

Leonard: Unless they have some sort of market-to-market regime, sort of like with when someone gives up their US residency, for instance, with certain pension plans and other things where you're considered to have a deemed distribution immediately upon expatriation. It would be horrible; any way to remedy this would just create more tax accidents.

John: Big problem. The only real remedy is pure residency-based taxation. And one of the things I find interesting is that nobody is actually proposing residency-based taxation. I think the holding bill is an excellent start but make no mistake, it's not the end of citizenship-based taxation. It well may be that all roads are going to continue to lead to renunciation.