Transition Tax

ADDRESSING THE UNINTENDED AND SEVERE CONSEQUENCES OF THE 17.5% REPATRIATION TAX IMPOSED ON SMALL BUSINESS CORPORATIONS OWNED BY INDIVIDUAL OVERSEAS AMERICANS

Republicans Overseas urges Congress to immediately address the Transition Tax

- The Tax Cuts & Jobs Act 2017 includes a mandatory 15.5% excise tax on the liquid assets (8% for fixed assets) of "foreign corporations". The tax is imposed directly on the "United States Shareholders" (owners) - this is referred to as the 'Transition Tax'.
- "United States Shareholders" can be corporations or can be individuals, conceivably including individual U.S. citizens abroad
- The "Transition Tax" applied to individual shareholders is at at higher rate (17.5%) than is applied to corporate shareholders (15.5%)
- While the Transition Tax will impact large multinationals in the repatriation of profits currently held overseas, the same tax applied to small businesses owned by overseas Americans could result in bankruptcy because individual shareholders must personally find the money to pay this tax while the individual shareholders of large corporations are not required to personally pay this tax.
- Overseas Americans are especially impacted by this tax due to:
  - the unintended and unaddressed consequences of the FATCA legislation passed in 2010 as part of the HIRE Act, and
  - the unique U.S. policy of imposing "worldwide taxation" on U.S. citizens living outside the USA.

- We urge the House to hold a hearing on the Transition Tax in order to:
  - Fully understand the unintended consequences that will impact the small business corporations owned by individual Americans living outside the United States.
  - Determine the best solutions to mitigate these consequences, including the exemption of small businesses owned and operated overseas by Americans residing overseas.

Small businesses owned by overseas Americans (‘small businesses’) are not the same as subsidiaries of multinational corporations (‘multinational subsidiaries’)

- Multinational corporations are the shareholders of their foreign subsidiaries, while individual American citizens are the owners/shareholders of their small businesses
- Under TCJA, profits earned by the multinational subsidiaries will no longer be taxed by the US government, but the profits earned by small businesses will continue to be taxed.
- Multinational subsidiaries are run to make a profit and benefit shareholders through dividends or higher share prices; small businesses are run to make a profit which is used to support the owner’s livelihood and to save for retirement.
- The TCJA will benefit the multinational corporations by giving them a lower tax rate and no longer taxing the profits from their foreign subsidiaries in return for a one-time transition tax; small businesses will not have a lower tax rate, will still have to pay tax on earnings to the US government, and will be forced to pay an additional tax: the transition tax.
- Multinational corporations will pay a 15.5% transition tax while small businesses will have to pay a 17.5% transition tax.
- Individual shareholders of multinational corporations will not be forced to find a way to pay for the transition tax as the multinational corporation is the shareholder for the subsidiary; individuals who own the small businesses will be forced to find a way to pay the transition tax and to make up any shortfalls from their own pockets.

The "Transition Tax" especially impacts Americans abroad because of its extra-territorial tax policies

- The United States is the only modern country to impose "worldwide taxation" on people who are "tax residents" of other countries and who do not live in the USA. This is referred to as citizenship-based taxation ('CBT').
- CBT means that Americans living overseas are subject to both U.S. taxation AND to taxation in their country of residence.
- CBT means that the "Transition Tax" is likely to result in "double taxation":
  - The "Transition Tax" will FIRST impose U.S. taxation on the retained earnings (without any realization event) held by non-U.S. small business corporations; and
  - SECOND the country of residence will impose taxation on those same retained earnings
- Payment of the "Transition Tax" to the USA will not generate a tax credit to offset the tax owed to the country of residence.
- Double taxation results from Americans abroad being subject to two tax systems on income generated outside of the USA.

The "Transition Tax" especially impacts Americans abroad because of the hostile business environment created by FATCA

- **FATCA ('Foreign Account Tax Compliance Act') has not acted as intended.**
  - FATCA was intended to prevent stateside American citizens from evading taxes by using non-US financial institutions and was expected to bring in hundreds of millions of dollars from hidden assets.
  - FATCA has brought in very little money, has cost overseas businesses billions of dollars in compliance costs, and has destroyed overseas Americans' access to financial services.
  - The 30% withholding penalty on US source income for financial institutions deemed to be non-compliant has led these institutions to minimize their exposure to risk by minimizing their exposure to overseas Americans.

- **FATCA has reduced access to the basic financial services needed to run a business.**
  - Foreign financial institutions deny or restrict the type of bank accounts available to overseas Americans.
  - Business bank accounts are routinely denied to overseas Americans.
  - If overseas Americans are able to get a business bank account, they are routinely denied business loans in order to minimize the bank's risk.

- **Overseas Americans who run small businesses must often self-finance, and the Transition Tax will effectively remove this source of finance for overseas Americans.**
  - In the absence of bank loans, overseas Americans use their profits to finance their businesses.
  - Without the ability to take out loans to cover payroll, buy stock, or invest in growth, these businesses will stop functioning and will go bankrupt.
  - In addition to stopping regular business functions that may require lines of credit, withdrawing 17.5% of working capital from these small businesses could also lead to bankruptcy.

The “Transition Tax” was intended to be the “quid pro quo” for moving to “Territorial Taxation” for multinationals – not to bankrupt small businesses

- **The switch to Territorial Taxation for Corporations (TTFC) was meant to attract companies to the US and grow jobs. In order for multinationals to receive the benefits of “territorial taxation”, the “Transition Tax” was imposed on their previously untaxed earnings.**
  - The primary aim of TTFC is to drive growth in jobs, profits, and tax revenues.
  - The Transition Tax is a MANDATORY tax on the previously untaxed earnings of US corporations holding trillions of dollars in foreign subsidiaries. The Transition Tax was the “trade off” in moving to “territorial taxation”.
  - Bankrupting American businesses is not a goal of the Tax Cuts & Jobs Act.
- **The Tax Cuts & Jobs Act 2017 does not differentiate between multinationals such as Apple and small businesses owned by overseas Americans—but it should.**
  - Overseas self-employed US citizens and green card holders who incorporated their businesses such as medical and legal practices, freelance writers, English language tutoring, or small internet businesses should not be treated as if they are Apple and IBM.
  - Americans overseas who own small businesses are not hoarding billions of dollars overseas that could be used to stimulate growth in the US. Overseas Americans use retained profits to finance their businesses, pay for their living expenses, and save for retirement.
- **In order to pay the Transition Tax, many small business owners will have to use (and lose) their pensions.**
  - In many countries, small corporations are commonly used to both support a livelihood and to build pensions.
  - The Transition Tax has no realization event—that is, it is not triggered by a specific event such as earning profit, which would necessitate paying tax on that profit.
  - Because there is no realization event, the Transition Tax is essentially a form of asset confiscation.
  - For many small business owners, their businesses act as their pensions. Taking money out of these businesses to pay a fictitious tax essentially becomes the confiscation of American citizens’ pensions.

Summary of how the “Transition Tax” will unfairly impact the small business corporations owned by overseas Americans

- Individual shareholders of small business corporations, unlike Corporate Shareholders, do NOT get the benefits of “Territorial Taxation” even though they are required to pay the “Transition Tax”.
- Individuals shareholders are required to pay a higher transition tax than Corporate Shareholders.
- Individual shareholders are required to personally find the money to pay the “Transition Tax” when the shareholders of Apple and Google are not.
- Individual shareholders may not have the money to pay the tax, because the tax is NOT based on any “realization event” (i.e. such as the generation of profit).
- Individual shareholders abroad (particularly in Canada) use their corporations as private pension plans. Payment of the “Transition Tax” would effectively confiscate their pensions.
- Individual shareholders subject to the “Transition Tax” would be subject to “double taxation”: first in the USA and then in their country of residence.

Potential Solutions

- **Solution I**: **Exempt small businesses owned by overseas Americans from the Transition Tax.**
  - Congress needs to recognize that small businesses owned by overseas Americans are different to the foreign subsidiaries of multinationals and define them as such.
  - Congress should then exempt overseas Americans' small businesses from the 17.5% Transition Tax.
  - Republicans Overseas strongly recommend this to be one of the fixes of the Tax Cuts and Jobs Act of 2017.

- **Solution II**: **Pass Territorial Taxation for Individuals (TTFI).**
  - America has a disconnect between how it taxes corporations and individuals. Corporations and their overseas subsidiaries are taxed on a territorial basis while individuals are still taxed under citizenship based taxation (CBT).
  - TTFI would tax an individual's income at source in the country where it is generated. Overseas Americans with tax residency in a foreign country would pay taxes in their host country on income generated in that country, while paying US tax on any income generated in the US.
  - Implementing TTFI would close discrepancies between how small businesses are taxed when profits are distributed.
  - Small businesses would no longer face discrepancies in taxation (or double or triple taxation) based on whether they pay themselves via salary, equity distribution, or a combination of both.
  - Republicans Overseas urges Congress to implement TTFI.

Urgent Action is required for overseas Americans!

- The legislation allows for the “Transition Tax” to be paid in 8 installments.
- The first installment is due by April 15, 2018.
- Failure to pay the first installment by April 15, 2018 means that the total tax would be due immediately.
- **If individual owners were unable to pay the first installment when due, they could not pay the entire tax either, and this would amount to the confiscation of the “pension” and/or bankrupting the individual.**
  - **Retained earnings could be sunk into working capital, making it difficult to easily access this as cash.**
  - **If the business is being legally operated as a pension vehicle, owners would be raiding their own pensions to pay this tax.**
- Republicans Overseas requests that the Congress immediately address this urgent issue to prevent the bankruptcy of thousands of law-abiding overseas Americans.

Summary

- Republicans Overseas urges the House to immediately hold hearings on the unintended consequences of the Transition Tax on overseas Americans' small businesses.
- Small business corporations owned by overseas Americans are not the same as the foreign subsidiaries of multinational corporations, and the law should address this.
- Overseas Americans are already doubly taxed under citizenship-based taxation, and the TCJA does not address this.
- Overseas Americans suffer from the unintended consequences of FATCA and are having to use retained earnings as working capital due to lack of access to financial services.
- Overseas Americans do not benefit from the Tax Cuts & Jobs Act, but will be unintentionally penalized by the Transition Tax.
- The first installment to be paid under the Transition Tax is due to be paid on April 15, 2018: urgent action from Congress is needed.
- Congress can resolve the unintended consequences of the Transition Tax by exempting overseas Americans' small businesses from it and by passing TTFI.