



TaxJourney

United States

December 19, 2024

End to U.S. Citizenship Based Taxation - A Possibility?

On **December 18, 2024**, Representative Darin LaHood, a member of the House Committee on Ways and Means, introduced the Residence-Based Taxation for Americans Abroad Act, a bill that would implement a residence-based taxation system for U.S. citizens currently living overseas. The legislation seeks to transition from the current citizenship-based taxation system to a residence-based taxation model, aligning the U.S. with the tax practices of other major countries.

Similar bills/initiatives have been proposed in the past. However, this legislative effort aligns with President-elect Donald Trump's campaign promise to eliminate U.S. income taxes for Americans living abroad, marking a significant shift in U.S. tax policy. These efforts reflect growing awareness of the unique challenges faced by American expats. Comprehensive reforms have yet to be implemented.

Key Provisions of the Bill

Residence-Based Taxation Election:

The bill allows U.S. citizens residing abroad to opt into a residence-based taxation system. Under this system, expatriates would be taxed solely by their country of residence on foreign income, exempting them from U.S. taxes on such income. However, they would remain liable for U.S. taxes on income sourced within the United States, as is the case for majority of the countries following source-based tax system.

Departure Tax for Wealthy Individuals:

To prevent tax avoidance by high-net-worth individuals, the bill introduces a "departure tax." The proposed tax would apply to those with a net worth exceeding the estate tax threshold (currently \$13.61 million) who choose to switch to the residence-based system. It effectively treats all their assets as if sold before the transition, ensuring the U.S. collects taxes on unrealized gains.

Exemptions from Departure Tax:

Under the proposal, certain expatriates can avoid the departure tax, including:

- Individuals who haven't lived in the U.S. since turning 25 or since March 2010.
 - Those who have resided abroad for at least three of the past five years and have complied with U.S. tax laws.
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Contextual Background

The current U.S. tax system requires citizens to file returns on worldwide income, regardless of residence, leading to complex compliance burdens, especially for middle-income Americans abroad. The United States stands alone among major nations in employing a citizenship-based taxation system, imposing taxes on individuals regardless of their residence or whether they earn income within the U.S. This proposed legislation would grant Americans residing abroad the option to be classified as non-resident Americans, subjecting them to U.S. taxes solely on income and gains derived from U.S. sources.

Recent estimates suggest that over 5 million U.S. citizens are currently residing abroad. This population includes Americans who were born and raised in the United States but have chosen to live overseas indefinitely, as well as "accidental Americans"—individuals with dual U.S. and foreign citizenship who may be unaware of their U.S. citizenship status.

In recent years, this issue has gained increasing attention and was a key priority for President-elect Trump during his campaign. In an October interview with *The Wall Street Journal*, President Trump expressed his support for reform, stating, "I support ending the double taxation of overseas Americans."

"This is a non-partisan issue that impacts U.S. citizens with ties to districts across the country," said Representative Darin LaHood. "In today's interconnected world, many Americans choose to live and work abroad for a variety of reasons. They should not be subjected to excessive tax and compliance burdens for doing so. I look forward to collaborating with President-elect Trump and my colleagues on both sides of the aisle to modernize our tax code and ensure Americans abroad are treated fairly."

"For the first time in decades, Americans living abroad can see a potential resolution to the significant challenges they've faced, including costly compliance fees, strained personal relationships, and the inability to live normal lives," said Brandon Mitchener, Executive Director of Tax Fairness for Americans Abroad (TFFAA). "We deeply appreciate Rep. LaHood's leadership and are eager to work with him to gather feedback and advance this bipartisan legislation to the president's desk next year."

Expatriate advocacy groups have expressed support for the proposal, highlighting its potential to reduce administrative burdens and financial strains on Americans living overseas. Representative LaHood is seeking bipartisan backing and public feedback to refine the bill, ensuring it addresses revenue considerations and effectively serves the expatriate community.

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