Request for uniform tax treatment of foreign and US mutual funds for long term non-resident US citizens

According to the press many foreign mutual funds and some foreign stock are considered by the IRS as passive foreign investment companies (PFIC) [1]. PFIC are subject to complicated and strict IRS tax guidelines. The annual reporting requirements are very heavy and PFIC capitals gains and dividends are taxed at the highest marginal tax rate of ordinary income. They are not taxed at the lower rates of passive income. In practice this means that non-resident US citizens are not allowed to invest in mutual funds in the country where they live. In order to avoid the punitive treatment of PFIC they can only invest in individual foreign stocks and bonds because the tax rules are the same as for US residents.

In practice this restriction makes it difficult to diversify investments and follow standards bank recommendations. While an individual can easily invest in European and American individual stocks and bonds, it is much more difficult to diversify into the other markets in Asia, Africa, or South America. How can you diversify your investments in Eastern Europe, Asia, Africa or South America without mutual funds or ETF?

The main difficulty with investing in individual stocks and bonds is that most large retail banks, at least in the country of Belgium where I live, is that bankers are not allowed to provide investment advice on individual stocks and bonds because they are too risky. Large retail banks mostly provide investment advice for mutual funds. This places long term non-resident US citizens, e.g. dual citizens such as myself, in a very difficult situation to manage their finances. Furthermore I have never found a list of which Belgian funds or stocks are considered as PFIC. None of the banks I have talked to have ever heard about PFIC.

Mutual funds and ETF are the modern way of managing investments. It lowers the financial risk by diversifying investments across continents and sectors. By purchasing a mutual fund or ETF an individual delegates the responsibility for managing individual stocks and bonds to a professional banker. Such fund managers use professional tools to manage risk by diversifying investments across sectors and countries. It relieves the individual investor of having to spend time following individual stocks and bonds. Most individuals don't have the time, knowledge, skills or motivation to manage investments in individual stocks and bonds.

By purchasing local mutual funds or ETF a long term non-resident US citizen is not trying to evade US taxes. He is just trying to save and invest for legitimate reasons such as saving to buy a house, for the children's education or for retirement. Investing from abroad in US mutual funds is not really an option: it is not possible or very difficult to open bank accounts or invest in US mutual funds if you are not a US resident. And it is not practical because you need to be able to see and talk to your banker to get investing advice and information.

The resulting end user experience is bewildering. You have to navigate two evolving tax systems, in my case the US and Belgian tax systems, to understand which financial products and services you can buy in your country of residence. Just because you hold a US passport you are denied access to modern financial products such as mutual funds and ETF in the country where you live. Why this unfair treatment?

US citizens should be allowed to invest in the mutual funds sold by the banks of their country of residence. Holding a US passport should not restrict your options for saving and investing in your country of residence. This could be considered as an exception to the general PFIC rule and could be incorporated into the Same Country Exception [2] that is proposed by the organization Americans Citizens Abroad (ACA). A better solution would be moving from Citizen based taxation (CBT) to residence based taxation (RBT) as proposed by ACA [3]. This would solve the issue of restrictions on investment in foreign mutual funds by non-resident US citizens in the country where they live.

References

[1] More Unofficial Capital Controls: PFIC Rules, http://www.internationalman.com/articles/more-unofficial-capital-controls-pfic-rules

[2] "Same Country" Exemption for FATCA reporting, https://americansabroad.org/issues/fatca/same-country-exemption-fatca-reporting/

[3] Tax Reform in 2015: Impact on Overseas Americans, https://americansabroad.org/files/6414/2352/3607/rbt-and-tax-reform-feb-2015-final.pdf