



AMERICAN CITIZENS ABROAD
THE VOICE OF AMERICANS OVERSEAS

Email and Post

The Honorable Carl Levin, Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
340 Dirksen Senate Office Building
Washington, DC, 20510

The Honorable Senator John McCain, Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
340 Dirksen Senate Office Building
Washington, DC, 20510

March 3, 2014

American Citizens Abroad, Inc. (ACA) submission to the Hearing on Off-Shore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts, February 26, 2014, 9:30 a.m., Dirksen Senate Office Building

Dear Senator Levin and Senator Coburn,

The stated focus of this hearing is on the status of efforts to hold Swiss banks and their U.S. clients accountable for unpaid taxes. ACA, a leading association representing the interests of American citizens resident overseas¹, would like to take this opportunity to alert you to the multifaceted and highly negative impact of measures undertaken on the entire community of Americans overseas, resident not only in Switzerland but throughout the world. These comments are based on the Taxpayer Advocate's 2013 Annual Report to Congress², the March 2013 GAO report on IRS's Offshore Voluntary Disclosure Program³, the GAO letter of January 6, 2014 addressed to the Honorable Carl Levin⁴, the IRS's quarterly report listing the names of individuals renouncing their U.S. citizenship⁵, and last but not least, testimonies of distress received at ACA from Americans resident abroad.

The UBS case in 2009 led to the breaking of Swiss banking secrecy and negotiations between the Swiss government and U.S. Treasury to determine rules and procedures about how to settle the past. This process is still underway and was the key focus of the hearing of February 26th.

Shortly after the UBS case began in 2009, the IRS initiated its first Overseas Voluntary Disclosure Program (OVDP); a second OVDP was initiated in 2011 with a set time limit; a third OVDP began in 2012 with no time limit. The IRS claims these OVDP to be a success, with 43,000 participants and \$6 billion collected.

Congress also passed the Foreign Account Tax Compliance Act (FATCA) in March 2010. The effective date of important provisions varies, but registration of Foreign Financial Institutions is underway now; the first wave of registrations will be completed by April 25, 2014; the first IRS list of participating FFIs will be published on July 2, 2014; a number of other key provisions become effective July 1, 2014. This legislation was aimed at stopping tax evasion through the use of foreign bank accounts.

Public statements of the IRS and members of Congress have often referred to “tax cheats” with no distinction between U.S. residents deliberately hiding assets in foreign bank accounts and overseas residents who by necessity have foreign bank accounts in their local bank. The OVDP was a one-size-fits-all program. Admittedly many Americans resident overseas were not filing U.S. tax declarations and the Foreign Bank Account Report (FBAR), but this was largely due to ignorance of their filing obligation, not deliberate tax evasion.⁶ In fact, an IRS study has shown that over 90% of Americans resident abroad owe no U.S. taxes. Since Americans abroad pay taxes in the first place to their country of residence, it commonly never occurs to them that a second filing to the United States is due under the unique U.S. system of citizenship-based taxation.

Americans living overseas had every reason to be unaware of their U.S. tax filing obligations. Prior to the UBS case, the IRS had minimal outreach to the community of Americans abroad. There had been very little enforcement by IRS and the Department of Justice or communication (outreach) by FinCen or the IRS as to the filing obligation. The majority of Americans overseas file without the assistance of a professional tax preparer because of the prohibitive cost (US tax preparers abroad are rare and expensive). Most filers must cull information from several sources to understand the various components of an overseas tax filing. Some instructions for overseas filing are found under individual taxation and others in the small business section of the IRS website, the process is not intuitive. Even qualified tax preparers in the big accounting firms, specializing in expat taxes, were sometimes unaware of the FBAR filing requirement. As evidenced by the Treasury Department’s 2003 Report To Congress under the USA Patriot Act, it was widely acknowledged that the Government’s outreach and education efforts with respect to the FBAR were deficient. It was only in 2009 that the IRS first mentioned the requirement to file the FBAR, in Publication 54.

Suddenly, under the OVDP, Americans resident abroad were treated as criminals in the same way as U.S. residents who were deliberately and wilfully evading taxes. Before the first OVDP, individuals living overseas could come into compliance simply by filing the past three years of tax declarations and paying any taxes due. It was a great shock and is still a shock to many Americans living abroad to learn that they are considered “tax cheats”, and that they risk losing a significant part of their life savings due to the excessive FBAR penalties of the OVDP, penalties which have become more severe with each successive version of the program.

It was not until September 2012 that the IRS, after many discussions with organizations of Americans living overseas, introduced the “Streamlined Filing Compliance Procedures”, a voluntary disclosure program specifically for Americans resident abroad. While this program is a step in the right direction and demonstrates that the IRS has finally recognized that Americans resident abroad should not be treated in the same way as U.S. residents, the

program is so restrictive and vague that it has led to more fear and questions; it is not meeting its objective to encourage Americans overseas to become compliant.

Since Americans resident overseas have the major part of their assets overseas, in contrast to U.S. residents who may have hidden a part of their assets abroad, their fear and incomprehension of the confiscatory FBAR penalties is highly understandable, particularly since most owe no or very little U.S. tax. This fear is accentuated by the poor reputation of the IRS's administration of the OVDP as outlined in several recent annual reports of the National Taxpayer Advocate which referred to "bait and switch" tactics in shifting regulations, and the official communications of IRS that did not give confidence to those who had made legitimate errors and oversight in their filing to come forward due to the extremely complicated, obtuse and expensive filing procedures. The Taxpayer Advocate has made a very valid point about the need for taxpayers to have confidence in the fairness and correct administration of the tax system.⁷ The excessive and unfair penalties imposed on benign cases of non-filing in the first Voluntary Disclosure Programs were confirmed by the GAO March 2013 report.⁸

From the point of view of encouraging Americans resident abroad to enter into compliance, the IRS voluntary disclosure programs have been a failure. The GAO has confirmed in its 2013 Report that as to the 2009 OVDP, only about 500 among the more than 10,000 participants studied had overseas addresses. This is insignificant when one considers that there are approximately 1 million Americans abroad who are filing, out of a total estimated population of 7.6 million.⁹ In addition, the GAO Report showed that only about \$125 million of the billions collected were unpaid annual taxes. Nearly two thirds of the amount collected is fines and penalties. If all Americans overseas became compliant, there would be little additional tax revenue as the population is similar to those who are compliant. This contradicts the frequently publicized claim that billions of taxes are lost to tax evasion by individuals every year.¹⁰ The OVDP has basically collected penalizing taxes on assets, which is contrary to U.S. tax law that only revenue is taxed.

In order for Americans resident abroad to come into compliance as they wish to do, ACA has strongly recommended adoption of a Comprehensive Compliance Program to the Treasury Department, and ACA urges Congress to encourage such an approach.¹¹ (See: http://americansabroad.org/files/7513/7452/3519/Final_Letter_to_Treasury-IRS_July_19_2013_copy.pdf)

With the heavy penalizing background of the OVDP programs, the new FATCA system is now moving forward as the Treasury Department negotiates Inter-Governmental Agreements (IGAs) with foreign governments to permit foreign financial institutions to provide information to the United States on all bank accounts owned by individuals whom the U.S. considers U.S. persons. Unfortunately, a significant consequence of FATCA legislation is that foreign financial institutions are refusing bank accounts for Americans resident overseas.

Many Americans abroad who are not yet in compliance now face a lose-lose situation. They don't know how to become compliant without excessive financial penalties even though they owe little or no taxes, and they have lost access to banking services essential for daily living in their country of residence. They are simply unable to live normal lives abroad. Even Americans abroad who are in full compliance with U.S. taxes are extremely bitter about their

treatment under the unique citizenship-based taxation system of the United States. Bank accounts are being closed due to FATCA, access to overseas jobs is restricted due to required FBAR reporting, investment in local non-U.S. mutual funds is impossible due to the PFIC reporting requirements, efficient saving for retirement is not possible due to U.S. tax treatment of contributions to foreign pensions and now the Medicare Tax NIIT of 3.8% is imposed with no allowance for foreign tax credits, which is blatant double taxation of Americans abroad. This latter tax is all the more objectionable as Americans abroad do not even have access to Medicare and yet they are being required to contribute to it in addition to their medical insurance costs in their country of residence. All of this is due to the United States' unique citizenship-based taxation coupled with aggressive U.S. techniques to stop tax evasion.

We urge you to support tax reform to adopt residence-based taxation, the efficient and fair taxation system applied throughout the entire rest of the world. It is urgent that the United States adapt their laws to the global realities of the 21st century, to preserve the community of Americans abroad who contribute so much to their home country. ACA's tax reform proposal recommending residence-based taxation is found at:

<http://americansabroad.org/files/6513/6370/3681/finalsubrbtmarch2013.pdf>

Sincerely yours,

Marylouise Serrato
Executive Director ACA, Inc.

End Notes

¹ American Citizens Abroad (ACA), founded in 1978, is a non-profit, non-partisan, volunteer association whose mission is to represent the interests of Americans living overseas. ACA has worked on a variety of issues of importance to Americans abroad, including taxation, citizenship, voting, Medicare, social security, and others. ACA has members worldwide and a network of 68 country contacts in 45 countries. In 2013, ACA was transformed into American Citizens Abroad, Inc. (ACA, Inc.), a Delaware non-profit organization intended to qualify as a tax-exempt under section 501(c)(4) of the Internal Revenue Code. ACA Executive Director, Marylouise Serrato, as well as the ACA Legal Counsel, Charles Bruce, are located in Washington, D.C. ACA, Inc. can be reached at info@americansabroad.org. The mailing address is 11140 Rockville Pike, Suite 100-162, Rockville, Maryland 20852, U.S.A. The ACA website, www.americansabroad.org, lists the ACA, Inc. Board members as well as the volunteer group of Professional Tax Advisors Council (PTAC).

² <http://www.taxpayeradvocate.irs.gov/2013-Annual-Report>

³ GAO, "OFFSHORE TAX EVASION: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion"

⁴ <http://www.gao.gov/assets/670/660005.pdf>

⁵ <http://www.forbes.com/sites/robertwood/2014/02/06/americans-renouncing-citizenship-up-221-all-aboard-the-fatca-express/>

⁶ See Bernard Schneider, "The End of Taxation Without End: A New Tax Regime for U.S. Expatriates" for a detailed analysis of the population of Americans resident overseas.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2186076

⁷ The position of the Taxpayer Advocate is clearly outlined by Professor Allison Christians, in "Taxpayers Rights, On and Offshore: The 2013 Taxpayer Advocate's Report to Congress.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2383432

⁸ GAO, OFFSHORE TAX EVASION: IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion, Table 2, page 13, highlights the excessive penalties on assets imposed on the first 10 percentile in relation to the taxes due; the small taxpayer was more severely penalized than the large tax evaders.

⁹ The GAO report has been analysed by Patrick W. Martin, tax lawyer in the following article:

<http://www.procopio.com/userfiles/file/assets/files1/the-2013-gao-report-of-the-irs-ovdp-2739.pdf>

¹⁰ Footnote 8 of the report of the Permanent Subcommittee on Investigations, "Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions of Hidden Offshore Accounts", February 25, 2014, references the study of Joseph Guttentag and Reuven Avi-Yonah, "Closing the International Tax Gap," in Max B. Sawicky, ed., Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration (2006) (estimating offshore tax evasion by individuals at \$40-\$70 billion in lost revenues annually)

¹¹ http://americansabroad.org/files/7513/7452/3519/Final_Letter_to_Treasury-IRS_July_19_2013_copy.pdf