American Citizens Abroad submission of testimony to the
House Ways & Means Oversight Subcommittee
Hearing with the National Taxpayer Advocate on Challenges Facing Taxpayers
Tuesday, February 8, 2022

American Citizens Abroad, Inc. and its sister organization, American Citizens Abroad Global Foundation hereby submit our Statement for the record.

American Citizens Abroad, Inc. (ACA) is a premier advocacy organization representing Americans living and working overseas. Headquartered in Washington, DC, ACA is non-partisan, non-profit (section 501(c)(4)), with a 40-plus-year history of advocating on behalf of the community of Americans living and working overseas. Alongside ACA is its sister charitable (section 501(c)(3)) research and educational organization, American Citizens Abroad Global Foundation (ACAGF).

Many of the issues addressed at the February 8, 2022, hearing on the challenges facing taxpayers also affect Americans overseas, however, in many respects, differently and in differing degrees. Many of these problems were highlighted in testimony provided by the National Taxpayer Advocate at the hearing and cited in her annual report to Congress (2022 Purple Book), several under the "Most Serious Problems" section of the report. ACA supports the adoption of Residence-based taxation (RBT) which we believe would address many of the challenges facing the American taxpayers living and working overseas as outlined in our testimony below. Residence-based taxation would remove the taxing and reporting to the IRS of foreign-sourced income however, US-generated income would remain taxable and reportable to the IRS

Challenges facing American taxpayers living and working overseas

<u>Difficulties in communicating with the IRS and creating online accounts.</u>

American taxpayers overseas encounter serious problems accessing and communicating with the IRS. To begin with, there is no toll-free phone number into the IRS for callers living outside the United States and wait times when calling can be significant (often several hours). Given the complexity of filing from overseas, and the overlapping regulations governing international businesses and individuals, most Americans overseas are unable to have their questions answered directly by the IRS agents handling the phone lines. This problem was exacerbated by the COVID-19 pandemic, as the already stretched IRS servicing was further reduced. Even professional tax preparers admit that the tax filing regulations governing Americans living overseas are difficult for the average taxpayer to understand. This forces most Americans overseas to pay for professional tax preparation services, the cost of which can run into the thousands of dollars for a "simple" filing.

There have been many recommendations put forth to improve IRS customer services such as implementing "call-back" technology as proposed by the National Taxpayer Advocate. However, improvements must take into consideration the needs of American taxpayers overseas as often these improvements are focused on the domestic tax filer. ACA has been instrumental in providing input to Ken Corbin, Chief Taxpayer Experience Officer, and his team on the special

needs of overseas American taxpayers. We hope our suggestions and recommendations, along with those of the National Taxpayer Advocate, will result in positive change.[1]

Coupled with the issue of contacting and communicating with the IRS is the issue of creating online accounts with the IRS and, for that matter, other government service providers like the Social Security Administration. Apparently, this is due in large measure to overseas Americans' lack of US indicia, such as a US physical mailing address, which is needed to verify their identity. Online IRS accounts are critical for overseas American taxpayers as these would allow individuals to consult IRS notifications, check on their returns and view the most current information on their filings on a timely basis. As the IRS currently relies on hard-copy mailings of notifications, which often arrive late and after the deadline for action for Americans living internationally, having this information available to overseas taxpayers online is critical.

The Taxpayer First Act has identified overseas American taxpayers as an underserved population of taxpayers, and the IRS recently instituted an identification tool, "ID.me," which relies on facial scans of taxpayers to authenticate their identity to create online accounts. ID.me is a private, third-party online identity verification service. Taxpayer privacy and security concerns have arisen. The IRS has said it is withdrawing the ID.me tool and will turn to other authentication methods. ACA shares the concerns expressed by Senate Finance Committee Chairman Wyden and Americans Abroad Caucus Chairwoman Maloney and others over the use of facial recognition. ACA believes that it is possible for a government-run online account creation mechanism with secure identity verification to be created and run by the IRS. There are many examples of this type of mechanism created by private financial institutions and others which would greatly benefit Americans overseas.[2]

Whatever the path forward for online account creation, the IRS must take into consideration, and make available to, Americans abroad. These taxpayers need to be able to pay taxes, get refunds, look at the status of their tax account, deal with notifications and other problems, with the same ease and reliability as a taxpayer living in the United States. In some instances, as will be outlined further in this testimony, it is absolutely essential that they have more expeditious notification. ACA, which is highly familiar with the practical problems of Americans living outside of the United States, should once again be looked to as a resource for the IRS to help construct tools that will meet community needs.

IRS penalty assessments

The systemic assessment of IRS penalties for information reporting for Forms 6038/6038A, which affects Americans overseas with an interest or ownership in a foreign business is another serious problem for overseas filers. The reporting requirements are substantially more expansive and cover a wide variety of reporting matters. Returns that are "incomplete" or not sufficiently "accurate" may be considered not filed and will result in automatic penalty assessments. A US citizen may have several reporting requirements for a tax year therefore exposing themselves to multiple assessments of penalties.

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[1] Limited Electronic Access to Taxpayer Records Through an Online Account Makes Problem Resolution Difficult for Taxpayers and Results in Inefficient Tax Administration https://www.taxpayeradvocate.irs.gov/wp[1]content/uploads/2021/01/ARC20_MSP_03_OnlineRecords.pdf Taxpayers Face Significant Difficulty Reaching IRS Representatives Due to Outdated Information Technology and Insufficient Staffing https://www.taxpayeradvocate.irs.gov/wp[1]content/uploads/2021/01/ARC20_MSP_02_Telephone.pdf

[2] Chairman's News | Newsroom | The United States Senate Committee on Finance

This mirrors a similar problem reported for Forms 3520/3520A.Forms 3520/3520A are for the reporting of certain foreign transactions with gifts and trusts. The IRS can take the position that a foreign pension, many mandated by law in the foreign jurisdiction where an American lives, is considered a grantor trust or an employee trust, thus triggering the filing of a 3520-A. Understandably, many Americans overseas are unaware that their foreign pensions are categorized in this manner. Even some tax preparers are unaware of this, and failure to file can result in automatic penalties starting at $10,000 per form. Many individuals are also not aware that they must report the receipt of a foreign gift or inheritance and may face a penalty of up to 25% of the gift. Again, this is an issue where a complex tax code, coupled with limited assistance or guidance from the IRS, leads to individuals who are not willfully avoiding their tax filing obligation, to become caught up in unjustified penalty assessments.[3]

Penalty assessments are also complicated by mail delays on both the US and international sides often resulting in taxpayers receiving notifications for actions arriving past the deadline in which to respond therefore triggering penalty and interest assessments simply because the taxpayer did not receive the notification on a timely basis. This is especially concerning given legislation such as the Passport Revocation Provision which can put an American at risk of being denied renewal of a passport or worse, having a passport revoked because of a tax debt Passport Revocation Legislation Update | Washington, DC | (americansabroad.org). Without access to online accounts where such information can be consulted or a dedicated call-center that is easily accessible and knowledgeable about this legislation and regulation affecting overseas filers, makes process resolution challenging.

Reporting regimes targeting tax evasion create filing confusion, complexity, and unwarranted penalties

Since 1970, all Americans holding financial accounts outside of the United States are required annually to submit a Foreign Bank Account Report (FBAR) or, under amended rules, FinCEN Form 114. This filing has a disproportionate effect on Americans living overseas who by virtue of living outside of the United States, have a majority of their financial accounts outside the United States, that is, their accounts are considered “offshore” by the US Treasury. For Americans truly residing overseas, these are not “offshore” holdings but in-country or local accounts. Taxpayers filing FinCEN-114 without the help of a professional return preparer, often believe that the form requires the declaration of checking and savings accounts. They are often not aware of the extensive breath of accounts that are intended to be declared, including some tax-free pension-related, investment and credit card-related accounts. Even some professional tax preparers are unaware of the extent of what needs to be reported, defaulting to recommending that clients “just declare everything.” As was demonstrated in the Overseas Voluntary Disclosure Programs (2014), many taxpayers became aware of the fact that they needed to report their foreign pensions on FinCEN 114 because these accounts were not considered equivalent to a US pension and, therefore, considered a reportable “bank” account. Those individuals, unwilful in their behavior and not engaging in any illicit content, entered into programs intended for individuals actively engaged in tax evasion, only to find themselves subject to severe penalties and fines for simply having mis-understood their filing requirements.

The Foreign Account Tax Compliance Act (FATCA) of 2010 added an additional layer of confusion to the bank account reporting requirements. FATCA requires the reporting on IRS

[3] The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute and Systemic Assessments Burden Both Taxpayers and the IRS https://www.taxpayeradvocate.irs.gov/wp[1]content/uploads/2021/01/ARC20_MSP_08_International.pdf

Form 8938, which is attached to the regular Form 1040, of certain (but not all) financial accounts held outside the United States, imposing higher thresholds for reporting for individuals living outside of the US ($200,000 year-end balances for individuals and $400,000 year-end balances for joint filers[4]), than FBAR, which requires the reporting of all accounts, totaling over $10,000. This duplicate reporting of financial accounts creates confusion about which accounts need to be reported on what form. This causes Americans overseas either to over report or under report, resulting in simple filing errors. The penalties, however, associated with these errors are likened to criminal tax evasion, not simple filing errors. Many cases, it follows, lead to the imposition of penalties that are disproportionate to the errors made.

ACA advocates for the harmonization of these two reporting systems into one form. In absence of harmonization, ACA advocates for increasing the threshold for FBAR reporting, which has never been adjusted for inflation, to mirror the reporting threshold for FATCA reporting – which recognizes a higher threshold for Americans living and working overseas, given that a larger percentage of their financial holdings will be outside of the United States .The National Taxpayer Advocate supports ACA's position for the harmonization of Form 8938 (FATCA) and Form Fin-CEN-114 (FBAR) reporting.[5]

ACA also strongly recommends the adoption of a Same Country Exemption (SCE) for FATCA reporting which would eliminate the need for Americans overseas to report and file a Form 8938 on bank accounts they legitimately hold in their country of residence, treating these accounts as what they are, essentially "local" to the Americans who owns them. These same accounts would also not be reportable by the foreign financial institutions where they are held, thus mitigating the banking lockout Americans overseas are experiencing same-country-exemption-2015-04-06.pdf (americansabroad.org). Same Country Exemption was seriously considered at the time of adoption of the final FATCA regulations. In all frankness, there is no good reason not to revisit this subject and put the exemption in the regulations. It would not require legislative action. It could be done, almost, in the wink of an eye. Congress should not be put to the trouble of adopting a bill to do this.

Passive Foreign Investment Companies (PFIC) creates onerous tax consequences and prevents Americans from investing in the countries where they live and work.

Americans abroad often run into serious tax consequences with their financial investments. This most often happens when investing in foreign mutual funds or foreign pensions that are taxed by the US as PFICs or Passive Foreign Investment Companies. Currency fluctuations also present an issue for US citizens who may need and want to invest in products offered in their country of residence using currency earned in their jurisdiction but tagged to the US dollar for tax reporting. Currency fluctuations can cause "phantom gains," gains resulting solely from the change in value of the US dollar (required for filing US taxes) against the currency in the country

[4] Single or filing separately from spouse: If you have more than $200,000 at the end of the year or $300,000 at any one time in the year in foreign financial assets, you'll need to submit Form 8938 Married filing jointly: If you are filing jointly with your spouse and have more than $400,000 by the last day of the year or more than $600,000 at any one time during the year, you'll need to submit Form 8938. This applies even if only one of the spouses lives abroad.

[5] Harmonize Reporting Requirements for Taxpayers Subject to Both the Report of Foreign Bank and Financial Accounts and the Foreign Account Tax Compliance Act by Eliminating Duplication and Excluding Accounts a US Person Maintains in the Country Where He or She Is a Bona Fide Resident https://www.taxpayeradvocate.irs.gov/wp[1]content/uploads/2021/01/ARC20_PurpleBook_02_ImproveFiling_9.pdf

where an individual lives. This presents serious issues for individuals who have used a foreign currency for their foreign transactions and have not patriated US dollars.

American taxpayers generally assume that accumulating funds in a foreign retirement account or a foreign mutual fund is a good idea. For taxpayers living overseas, however, that proposition is not a sure thing given the possible tax consequences due to this investment being considered a PFIC resulting in US tax rates that can top 50%. The complexities, and penalties, presented by tax rules on foreign accounts present special problems for American citizens living abroad, problems that their US-resident counterparts are unlikely to ever confront, especially by accident. Americans living abroad are more likely than those who do not to own foreign accounts. And they may not even know whether that account qualifies as a PFIC under IRS rules. In addition to paying high taxes on these investments (many of which are mandated by foreign jurisdictions in the case of some pension funds) the taxpayer must also fill out a Form 8621 to calculate and report those investments, which the IRS itself estimates will take more than 48 hours to complete.[6]

Currency fluctuations and phantom or fictious gains

As noted previously, Americans living overseas must use the US dollar as their functional currency for tax reporting. Currency fluctuation is virtually impossible for expats to plan around. The volatility can cause taxable events for Americans trying to do normal life transactions such as having a credit card, taking on a mortgage to buy a house, or selling property or investments.

Currency fluctuations can cause taxable events for Americans trying to do normal life transactions when the individual in question has never patriated US dollars and is functioning in currency earned and investment in the country in which they live. Phantom or fictitious gains on debt forgiveness if the US dollars appreciates over the term of the mortgage can be virtually impossible for everyday taxpayers to keep track of. Most Americans not trying to speculate on price changes, and most are working in their local jurisdiction currency and are not patriating US dollars. To complicate the situation phantom gains are taxable however, phantom loses cannot be taken as a tax credit. The situation can be dramatic to life altering for someone for example, who purchased property in 1970 in German Deutschmarks and is now selling the property in 2022. They must now calculate the original purchase and sales prices into dollars at the exchange rate of the time and report in US dollars when no dollars were patriated to make the purchase. The resulting sale could create a fictious gains tax that is not represented in any actual monetary gain in order to pay the taxes.

Tax reporting for small business creates burdensome paperwork and high costs for compliance

Independent and small businesses overseas owned by Americans face increased burdens when it comes to annual tax filings. A US citizen who falls within one of the five categories of required filers of Form 5471, which usually but not always entails an ownership interest, must file this form. Form 5471 is estimated to take 32 hours to complete as it is more complicated than other international tax reporting forms and requires significantly more information from the filer. When coupled with the GILTI and Transition tax filing requirements, tax filings for an independent or small business become complex, confusing and will extend well beyond the estimated 32 hours to complete. This forces many small businesses to hire professional tax accountants, paying fees that are disproportionate to the tax owed or the business itself.

[6] Instructions for Form 8621 (01/2022) | Internal Revenue Service (irs.gov)

These taxpayer burdens often occur when the IRS makes and/or changes rules without considering all the various taxpayers that will be affected. This is often the case with Americans overseas. The Tax Cuts and Jobs Act (TCJA) legislation passed in 2017 with the Global Intangible Low Income (GILTI) and Transition tax regimes focuses on US multi-nationals that are offshoring profits and not the small coffee shop in Stockholm, the yoga studio in Paris or the one-man consultancy in Budapest owned by Americans.

Some small businesses overseas caught up in the TCJA reporting regime could not afford the cost to come into compliance and simply closed their businesses. Congress and the IRS did not do the research necessary to determine how many small American-owned businesses were located overseas and simply determined that to set up a business overseas was no easy task and, therefore, there are essentially no small businesses owned by Americans overseas. This is not the case and there are many small businesses owned by Americans overseas that may have been created or organized under foreign local laws, but as they are owned by Americans, would be considered a US business. These businesses can be big or small and have probably not been incorporated taking into consideration US tax law. Some of the individual who are subject to the repatriation tax might not have in hand the actual monies needed to pay this tax.

ACA testified to the IRS on October 22, 2018, highlighting the issues that the GILTI and Transition Tax imposed on Americans overseas noting the oversight in application of the Regulatory Flexibility Act (RFA) and the Paperwork Reduction Act (PRA). Although the IRS has given some relief to overseas Americans with regard to GILTI and Transition Tax (essentially allowing them to return to the old rules), this clearly indicates where rules created did not take into consideration Americans overseas, causing some to have to close up shop or incur serious tax and compliance costs disproportionate to their business. ACA continues to recommend the application of a *de minimis* rule for the Transition Tax and GILTI regimes. A *de minimis* rule would take out from reporting small businesses overseas that were never intended to be caught up in TCJA. aca-comm-testimony-irs-965-regs-22-oct-2018.pdf (americansabroad.org)

Determination of willful versus non-willful behavior disincentivizes coming into compliance

Since the passage of the Foreign Account Tax Compliance Act (FATCA) in 2010, many overseas Americans were made aware of their need to file tax returns and a FinCEN-114. A majority of these individuals were non-willful in their failure to file, some having been overseas 40 or 50 years prior to when many of the changes in tax law and passage of new regulations came into effect. The IRS's need for a subjective interpretation of willful behavior is understood to ensure that those who are truly willful don't slip through the cracks. However, many overseas taxpayers want to do the right thing and catch up on their FBAR filings and most truly did not know they needed to file or misunderstood the types of accounts needed to be listed on FinCEN-114. Many individuals still are unclear about the reporting requirements and differences between what is reportable on an FATCA Form 8938 and on an FBAR FinCEN-114 and continue to make filing errors based on a simple misunderstanding of the rules.

Not understanding what the IRS will consider "willful" behavior leads many of these individuals to shy away from coming into compliance, and given the media reporting of the past experiences of "non-willful" individuals who were caught up in the Overseas Voluntary Disclosure Programs (OVDP) -- programs which were never intended for the non-willful -- and with no clear cut understanding of how the IRS will view their behavior, many simply continue to avoid filing FBARs out of fear of the excessive penalty applications for non-willful behavior.

ACA supports the National Taxpayer Advocate's recommendation for modifying the definition

of willful for purposes of determining FBAR violations and reduced maximum penalty amounts. Criteria used to determine "willful" behavior in determining those taxpayers eligible to enter into the Streamlined Filing Compliance Procedures should be transparent.[7] This procedure, developed in response to the lack of a compliance program for individuals who were not willful in their failure to report FBARs or to include all accounts on an FBAR, gives the IRS wide discretion in determining and individual's behavior as willful or non-willful.

ACA can attest, as can the National Taxpayer Advocate, to many cases where the harshness of the maximum penalty for willful is disproportionate to the actual reporting failure. With such discretion between determining willful and non-willful behavior, it can be difficult for taxpayers to establish that a violation was not willful. If the goal of the Streamlined Filing Compliance Procedure is to encourage taxpayers to "get right with the system" and ensure continued tax compliance, taxpayers need the assurance their actions will be fairly judged.

Summary

Again, ACA believes that the way forward to alleviate many of the tax and filing issues is adoption of Residence-based taxation (RBT). Residence-based taxation removes taxing and reporting to the IRS of foreign income. Residence-based taxation is the global norm for most industrialized nations, the US being the outlier in this regard.

ACA has done extensive work in support of RBT beginning with our side-by-side comparative or roadmap showing current tax law and where in the tax code changes are needed to adopt RBT residency-based-taxation-aca-side-by-side-comparison-current-law-and-vanilla-approach-180420-1600.pdf (americansabroad.org). ACA's sister organization responsible for research and educational efforts, ACA Global Foundation (ACAGF) American Citizens Abroad Global Foundation - Home (acaglobalfoundation.org), raised funds in 2017 to run revenue estimates on ACA's "roadmap" for RBT and found that it could be made revenue neutral within a 10 year period DEG_short_memo_on_RBT_proposal_11.06.2017.pdf (americansabroad.org).

The research work was done by an independent, non-partisan consulting firm in Washington, DC, District Economic Group (DEG) districteconomics.com and has been presented to Congressional leadership, the tax writing committees in both the House and Senate, the Joint Committee on Taxation (JCT) and the US Treasury. ACAGF has updated the 2017 research project and we expect to announce the results of this research in the coming weeks. Key to our data set is defining the size, income and asset make up, compliance and investment practices of Americans living and working overseas. To our knowledge, there is no complete US government record of this information. The IRS has some information, and the US State Department has additional information. However, we believe that ACA has the best privately held data of this nature for Americans living and working overseas.

ACA's research, along with testimony from Americans overseas and testimony from other organizations working on the tax and compliance issues for Americans overseas, needs to be

[7] Modify the Definition of 'Willful' for Purposes of Finding FBAR Violations and Reduce the Maximum Penalty Amounts.
https://www.taxpayeradvocate.irs.gov/wp[1]content/uploads/2021/01/ARC20_PurpleBook_04_ReformPenInts_35.pdf

put on official record with the Congress through hearings held by the House Ways & Means Subcommittee on Select Revenue Measures. ACA is calling for the House Ways & Means Subcommittee to hold hearings and has community support for this through our write-in campaign. American citizens living overseas number between 4 and 5 million according to ACA estimates. Never has this community been given the opportunity to present their specific issues at government hearings. For Congress to consider corrective measures through legislation and regulations, it first must hear from, and understand, the issues from the community and those representing them.

ACA would like to thank the House Ways & Means Subcommittee on Oversight for the opportunity to submit this testimony and commentary. For more information, please visit the ACA website www.americansabroad.org or telephone +1 202 322 8441 and/or email marylouise.serrato@americansabroad.org.

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