"It Hurts My Heart:"
The Case for Fairer Taxation of Non-Resident US Citizens

by Laura Snyder*

Post 3 of 4

This is the third of a series of four posts to make the case for fairer taxation of non-resident US citizens and green card holders. The first post was a Case Study in the Marginalization of Americans Living Overseas. The second post recounted the origins of the situation, unique to the United States. This third post describes the destabilizing effects of recent US banking regulations and explains how the 2017 Tax Cuts and Jobs Act[1] turned an already difficult situation for entrepreneurs and small business owners into an impossible one.

I. Banking Regulations Further Complicate the Situation

Further complicating the situation of US citizens living overseas was a law first adopted in 1970, about 100 years after the first non-resident taxation laws. That law was the Bank Secrecy Act. It created various financial reporting obligations the ostensible purpose of which was to identify and collect evidence against money laundering, tax evasion and other criminal activities. The law includes the obligation for all US residents as well as US citizens, regardless of where they reside, to report to the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) all the financial accounts he/she holds with any foreign financial institutions. Referred to as "Report of Foreign Bank and Financial Accounts" or FBAR, any account held in any non-US financial institution was considered to be "foreign" and thus subject to the reporting requirement even in the case of the bank and other financial accounts US citizens residing overseas held in their country of their residence.[2] Given that the reporting requirement is triggered if the amounts in the accounts in the aggregate exceeds just $10,000 at any time during the reporting year (an amount that has not been adjusted since 1970 and is worth $65,000 today[3]), this means that any US citizen residing overseas of even relatively modest means is required to report all of his/her accounts, including those held in their country of residence as a normal and essential part of their everyday life. And they are required to report them to a "Crimes Enforcement Network" under the assumption that merely holding the accounts—again, accounts required for normal day-to-day life—was a crime.[4] However, during the first three decades after the adoption of the Bank Secrecy Act very few US citizens residing overseas were aware of their FBAR obligations and, at the same time, FinCEN's enforcement powers were limited. Accordingly, compliance by US citizens residing overseas was sparse.[5]

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In sum, for many years and indeed decades, US citizens living overseas were in a situation that, while awkward and ambiguous, was more or less tolerable: On the one hand many US citizens living overseas (and especially those who had never lived in the United State or who left when they were children) lived in blissful oblivion, subject to taxation in their countries of residence and never imagining that they might also be subject to US non-resident income taxation on their non-US income or to FBAR. As for those who did have an awareness of some kind, while some did file US income tax returns and FBARs, many did not (in both cases they did pay taxes their countries of residence). For those who did not file US income tax returns and FBARs, as long as the United States did not make any significant efforts to enforce compliance then it was best to let sleeping dogs lie. That is, it did not make sense to mobilize the huge resources needed to challenge non-resident taxation or FBAR if they were not enforced and simple non-compliance was a realistic and sensible alternative.

A. An Awkward but Stable Situation Upset by the Patriot and Hire Acts

While this situation was less than ideal, it was relatively stable. The first threat to this stability came in 2001. In the wake of the terrorist attacks of September, 2001, the Patriot Act directed the Treasury Department to improve FBAR enforcement. In the years that immediately followed the Treasury Department formally acknowledged that the primary target of FBAR was tax evasion rather than money laundering or other financial crimes and the Department delegated enforcement of FBAR to the IRS. Further, the American Jobs Creation Act of 2004 significantly increased FBAR penalties, including a fine of $10,000 per violation in the event of a "non-willful" failure to report [6] and a draconian fine in the event of a "willful" violation: the greater of $100,000 or 50% of the account balance.[7] As a result of these measures compliance with FBAR did increase.[8] But even so the rate of compliance remained relatively low[9] and it seemed that most enforcement actions brought under FBAR[10] were against persons residing inside the United States rather than outside.[11]

The 2010 adoption of the Hiring Incentives to Restore Employment (HIRE) Act had an even more significant impact. Referred to as a "jobs bill," the purpose of this legislation was to provide payroll tax breaks and incentives for businesses in the United States to hire unemployed workers.[12] Subtitle A of that law—the portion of the law that is referred to as the Foreign Account Tax Compliance Act (FATCA – a purposeful allusion to "fat cats"[13])—purportedly sought to offset the costs of HIRE by looking to increase the collection of taxes from sources outside the United States.[14] This was done in order to meet the requirements of the then recently adopted Statutory Pay-As-You-Go Act (or "PAYGO"), which sought to ensure that most new government spending is offset by spending cuts or added revenue elsewhere.[15]

The principal justification offered by Congress—and notably by Senator Carl Levin of Michigan—to make up for the cost of the HIRE Act by looking outside the

United States for tax revenue is this single statement and footnote in the first line in the 2008 Report from the Senate Subcommittee on Permanent Investigations:[16]

> *Each year, the United States loses an estimated $100 billion in tax revenues due to offshore tax abuses.*

However, when the accuracy of this statement was investigated, it turned out that the person to whom the statement is credited, an attorney named Jack Blum, could not explain any kind of statistical methodology that he applied in order to arrive at his estimate. When pressed to explain where the number came from, he responded "You just have to take a guess at it."[17]

B. FATCA Is Not a Tax nor Does It Organize for the Payment of Any Tax: So, What is Its Purpose?

Indeed, more cynical commentators have opined that FATCA was never intended to close any tax revenue gap in any significant manner—that this explanation was little more than a pretense. Instead, the primary purpose of FATCA was for the U.S. government to obtain otherwise private financial information and, ultimately, control of the global financial industry.[18]

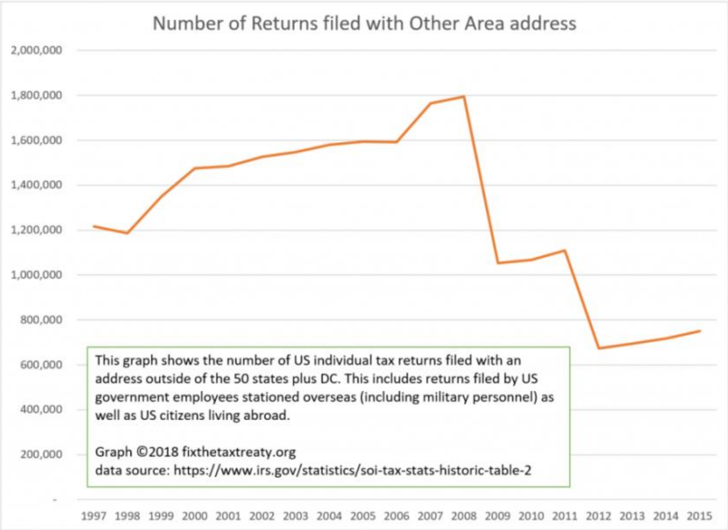
An examination of FATCA bears this out. It is not itself a tax nor does it organize for the collection of any tax. Instead, it strong-arms foreign financial institutions into disclosing private financial information to United States tax authorities. More specifically, it obliges foreign financial institutions to report to the IRS detailed information about all accounts held by "US persons." The information includes the account holders' names and addresses and the accounts' balances, receipts, and withdrawals. Foreign institutions who fail to comply are severely penalized with the application of a withholding tax of 30% on all payments of the institution's US-source income.

FATCA also imposes additional reporting obligations on taxpayers, in addition to and duplicative of those of FBAR. More specifically, it requires US citizens holding foreign financial assets with an aggregate value of more than $50,000 to include a report about those assets with their annual tax return. This obligation exists separate from and addition to FBAR reporting with respect to most of the same accounts.

C. FATCA has Not Resulted in Either Increased Tax Compliance or Increased Tax Revenue

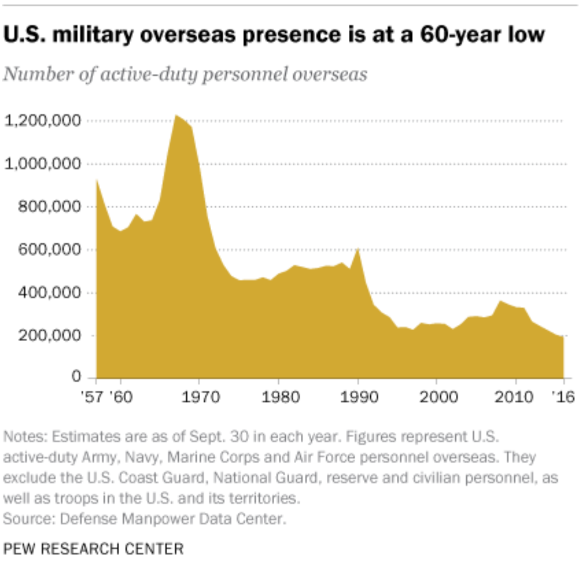
The intention of FATCA to establish US control over the global financial industry is also borne out in the extent to which the extraterritorial law has effectively resulted in increased tax compliance and has closed any tax revenue gap. In a nutshell, it hasn't done either:

As regards tax compliance: The IRS publishes data with respect to returns filed with an address outside the United States. These returns include not just "expats" but also US government employees and active duty military personnel stationed outside the United States.[19] This data demonstrates that the number of such returns has declined dramatically since 2009:[20]



Source: Karen Alpert, Fix the Tax Treaty

Interestingly, this decline appears to track closely the decline in the number of military personnel stationed outside the United States:



Source: Pew Research Center and Karen Alpert, Fix the Tax Treaty

In sum, there is no data demonstrating that FATCA has resulted in an increased rate of tax compliance by US citizens living outside the United States.

As regards tax revenue: To begin, even at the time FATCA was adopted no one believed that it would generate anything close to Blum's and Levin's estimate of $100 billion. Instead, the Congressional Joint Committee on Taxation estimated that FATCA would generate $8.7 billion in tax revenue between 2010 and 2020, and that just by the end of 2016 it would generate $4.8 billion.[21]

But there is no evidence that FATCA has generated even that much tax revenue, or even evidence that it has generated any significant tax revenue at all. The only information the Treasury Department has offered is a 2016 announcement that it had collected about $10.5 billion in taxes, interest and penalties pursuant to a series of Offshore Voluntary Disclosure Programs (OVDPs) and other streamlined filing procedures.[22] While the Department's announcement mentioned FATCA, the reality is that very little if any of the amounts collected can be attributed to FATCA: The OVDPs and other procedures in question were implemented prior to the adoption of FATCA and the disclosures and payments they engendered were driven not by FATCA but by the erosion of Swiss bank secrecy.[23] Further, as the Treasury Department noted, the amounts collected included not just tax revenue but also interest and penalties. These penalties were, for the most part, those resulting from failures to comply with FBAR; as mentioned above, the bulk of those penalties were assessed against persons residing inside the United States rather than outside.[24]

Indeed, the fact that FATCA has not generated significant tax revenue is implicit in a July 2018 report issued by the Treasury Inspector General for Tax Administration (TIGTA) subsequent to its audit of the IRS. The purpose of the audit was to evaluate the IRS's efforts to ensure compliance with FATCA by taxpayers and foreign financial institutions. The audit concluded that, despite spending nearly $380 million, the IRS "is still not prepared to enforce compliance"[25] with FATCA. Of course, if the IRS cannot demonstrate compliance with FATCA then neither can it credibly attribute any increased tax revenue to it.[26]

D. FATCA Places Heavy Burdens on Foreign Financial Institutions and Turns US Citizens Living Overseas into Pariahs

So, if FATCA hasn't offset the costs of HIRE or indeed demonstrably led to any increase in tax revenue, what has it done? As noted above, FATCA places obligations on both foreign financial institutions as well as individuals. For each, compliance has come at a considerable price.

As regards the costs placed on foreign financial institutions (FFIs): FATCA requires FFIs to apply processes enabling the FFIs firstly to identify among all account holders those who are "suspected US persons"[27] and attempt to verify their status. For each such person, the FFI must collect and report a host of information: name, address, birthdate, account number(s), account balance(s) and taxpayer identification number. Again, the failure to comply is subject to draconian penalties—a withholding tax of 30 percent on all payments of the FFI's US-source income.

Not surprisingly, FFIs have incurred substantial costs in developing and implementing the required processes: consulting fees, software development, dedicated personnel, etc. While no one has performed a comprehensive study of the total costs incurred by FFIs in order to comply with FATCA, there is some information available: the Spanish bank Banco Bilbao Vizcaya Argentaria estimated in 2014 that compliance costs could range from $8.5 million for a local entity to $850 million for a global one. The British government estimated the aggregate initial costs to UK financial institutions at $1.1 billion to $1.9 billion, with a continuing cost of $60 million to $100 million a year. More globally, KPMG and Deloitte have estimated that more than 250,000 foreign financial institutions are affected by FATCA, with costs for some of the larger ones reaching more than $200 million.[28]

The burdens FATCA imposes on FFIs are borne not only by the institutions themselves but also by their clients and prospective clients, and most especially by those individuals who are "suspected US persons." These burdens certainly include higher fees charged to clients.[29] But those fees are just the beginning. In their efforts to avoid FATCA-related costs and liabilities, FFIs around the world are:

- Refusing to open new bank, investment, retirement and other financial accounts for "suspected US persons,"[30]
- Closing existing bank, investment, retirement and other financial accounts held by "suspected US persons,"
- Pressuring non-US persons holding joint accounts with "suspected US persons" to remove the US person as an account holder,
- Refusing to grant mortgages to US persons or imposing higher rates on US citizens.[31]

These are not the only costs of FATCA borne by individuals. Americans living outside the United States are also being refused:

- Employment opportunities that require the American to have signature authority for the non-US employer's bank accounts,
- Investment and entrepreneurial opportunities with non-US investors/partners,[32]
- The ability to serve as trustee or hold power of attorney in relation to an elderly or disabled family member's financial affairs,
- Opportunities to serve as an executive officer with signature authority for a non-US not-for-profit (and even to serve as treasurer for a PTA equivalent!).

In each of these cases, the American living overseas is treated as a pariah—as someone to be avoided because their involvement will result in the need to report the underlying accounts—accounts that have nothing to do with the United States—to US tax authorities.

E. Some Especially Insidious Consequences of FATCA

Many US citizens living overseas are married to persons who are not US citizens. Many of these US citizens are prevented from holding joint accounts and other assets (such as real estate) with their spouses. This occurs either because the financial institution holding the accounts rejects the US citizen as an account holder and obliges the non-US citizen spouse to remove the US citizen from the account, or because the non-US citizen spouse understandably objects to having his/her account or other information submitted to US authorities or to have the asset be subject to US taxation and so refuses to hold the account or other asset jointly with their US-citizen spouse. In either case, this presents the US citizen with the problem of lack of access to the household's assets. While this is less than ideal for all such US citizens, it is disastrous for those who are financially dependent upon their non-citizen spouse, such as stay-at-home parents without incomes of their own (the majority of whom, of course, are women). They are especially vulnerable because in the event of divorce or the death of their spouse their access to the funds in those accounts will be restricted.

Another especially insidious consequence of FATCA concerns persons referred to as “Accidental Americans.” As described above, these are persons who have never lived in the United States or who have lived there only for a short time when they were children. Since leaving the United States they have had little to do with the country: they never obtained social security numbers, they never asked for a US passport, some did not even realize that they are considered to be US citizens. So, imagine their surprise when they have trouble banking in their home country for the simple reason that they were born in the United States. In some cases, banks have simply closed their accounts, refusing as clients any “suspected US person.”[33] In other cases, banks have required that they provide their social security number in order to keep their accounts open, but they do not have one and obtaining one is a lengthy and in some cases impossible process.[34] Some have attempted to come into compliance with US tax obligations via an amnesty program,[35] but in many cases this has proven impossible due to the exceptionally high professional fees they would need to pay simply to complete the complex paperwork. In order to address these problems many have sought to renounce their US citizenship, but this also involves a complex and costly process that many persons are not able to pursue.[36] The result is that “Accidental Americans” find themselves in an impossible situation: unable to comply with the “obligations” of their unwanted US citizenship and unable to renounce. So, either they are forced to live underground or they live in constant fear that the bank and other financial accounts they’ve managed to hold on to will be closed and they will face other forms of discrimination for the simple reason that they are “suspected US persons.”[37] Indeed, in a recent survey to Americans living abroad, several of whom self-identified as Accidentals, several participants testified to foreign financial institutions disrupting their lives because of costly IRS-reporting requirements.[38]

II. The Tax Cuts and Jobs Act Further Penalizes US Citizens Operating Small and Medium-Sized Businesses Outside the United States

The international provisions in the Tax Cuts and Jobs Act adopted in December 2017 were intended to target large multinational companies like Google and Apple. However, those provisions are having devastating effect upon US citizens who live outside the US and who own small or medium-sized businesses in their countries of residence.[39] These provisions are referred to as the “Repatriation Tax” or “Transition Tax,” on one hand and “GILTI,” on the other.

The Repatriation Tax requires individual US-citizen shareholders of a non-US company to pay a one-time tax of at least 17.54% of the post-1986 retained earnings of the company.[40] Given that the tax applies to retained earnings, by definition it is due in the absence of any distribution by the company or any other realization event. This tax imposes an especially serious burden on small and medium-sized business owners who live in countries where such companies are used as retirement vehicles: the tax means that they will lose a large percentage of the funds they had counted on for retirement.[41] It is for these reasons that the Repatriation Tax has been described not as a tax but as confiscation, and in particular as confiscation of pensions.[42] To add insult to injury, the distribution of these retained earnings to the shareholder enabling him/her to pay the Repatriation Tax will trigger distribution and income taxes in their country of residence and limited credit for these taxes will be allowed.[43] Further, individual US-citizen shareholders of foreign companies will not be able to benefit from the shift to territorial taxation in the manner that US-based corporate shareholders of foreign companies will.[44]

Global Intangible Low Taxed Income ("GILTI") requires that, on an ongoing basis, US-citizen shareholders of foreign companies include in their personal tax base a share of certain types of the company's earnings. In a manner similar to the Repatriation Tax, this tax must be paid regardless of whether or not the company actually pays out such amounts to the shareholder in dividends. And, if the company does indeed pay out any amounts in order to enable the US citizen to pay the GILTI tax, those dividends will, of course, also be subject to local taxes for which only limited US tax credits will be allowed.[45]

The next and last of this series of three posts will expose continuing prejudices, misconceptions and misunderstandings and how they serve to perpetuate and aggravate the situation for so many US citizens who seek simply to lead normal lives in the places where they live.

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[2] "FBAR Legislative History," Sherayzen Law Office, Jan.8, 2017, http://sherayzenlaw.com/fbar-legislative-history-fbar-tax-attorney-minneapolis/.
[3] This calculation can be performed at this link : https://www.usinflationcalculator.com/.
[4] Ruth Mason, "Citizenship Taxation," *Southern California Law Review* 89 (2015): 214, https://ssrn.com/abstract=2606744, observing that these accounts shouldn't arouse suspicion.
[5] Stephan Michael Brown, "One-Size-Fits-Small: A Look at the History of the FBAR Requirement, the Offshore Voluntary Disclosure Programs, and Suggestions for Increased Participation and Future Compliance," *Chapman Law Review* 18 (2014): 247, https://www.chapman.edu/law/_files/publications/CLR-18-stephan-brown.pdf.
[6] "FBAR Legislative History," Sherayzen Law Office.
[7] Brown, "One-Size-Fits-Small," 249-50.
[8] Ibid., 244.
[9] Mason, "Citizenship Taxation," 219.
[10] Brown, "One-Size-Fits-Small," 254-59; "Enforcement Actions," Financial Crimes Enforcement Network, https://www.fincen.gov/news-room/enforcement-actions.
[11] William Byrnes, "Background and Current Status of FATCA and CRS," Texas A&M University School of Law Legal Studies Research Paper No. 17-75, Sept., 2017, 1-15 to 1-16, https://ssrn.com/abstract=3045459.
[12] "2010 HIRE Act: Tax Breaks for Small Business," HIRE Act of 2010, 2010, http://hireact.org/.
[13] Al Kamen, "IRS: Disclose Those Foreign Assets," *The Washington Post*, Jan. 12, 2012, https://www.washingtonpost.com/blogs/in-the-loop/post/irs-disclose-those-foreign-assets/2012/01/18/gIQArMzGBQ_blog.html?utm_term=.43ae52ea3be7.
[14] Charlie Wilson, Jr., "Wilson Votes to Create Jobs, Boost Small Business and Rebuild Infrastructure," Vote Smart, March 25, 2010, https://votesmart.org/public-statement/495831/wilson-votes-to-create-jobs-boost-small-business-and-rebuild-infrastructure&speechType=4#.XDXDPlxKjIU. Representative Henry Cuellar of Texas announced

the adoption of the HIRE Act in part as follows: "Over the next 10 years, the HIRE Act is fully paid-for, as Congress will adhere to strict Pay-As-You-Go (PAYGO) spending rules." Ashley Patterson, "Jobs Bill Passes, Delivers Tax Cuts to Small Businesses," March 4, 2010, https://cuellar.house.gov/news/documentsingle.aspx?DocumentID=174857. See also: Denis Kleinfeld, "Will FATCA Ever Become a Success?" January 17, 2019, https://www.newsmax.com/finance/kleinfeld/fatca-success-tax-money/2019/01/07/id/897136/, stating "FATCA was passed devoid of any valid data or analytical justification."

[15] PAYGO was enacted in February, 2010, just one month before the HIRE Act was enacted in March, 2010. "The Statutory Pay-As-You-Go Act of 2010: A Description," Office of Management and Budget, https://obamawhitehouse.archives.gov/omb/paygo_description/, http://hireact.org/.

[16] Byrnes, "Background and Current Status of FATCA and CRS,"1-8 to 1-9.

[17] Ibid., 1-9 to 1-10.

[18] Ibid.,1-4 . See also: John Paul, "The Future Of FATCA: Concerns And Issues," *North East Journal of Legal Studies* 37 (2018): 64, https://digitalcommons.fairfield.edu/cgi/viewcontent.cgi?referer=https://www.google.fr/&httpsredir=1&article=1057&context=nealsb, observing that New Zealand tax authorities publicly admitted that FATCA violates the human rights of US citizens but decided to enforce it anyway out of fear of the United States; and Elizabeth Thompson, "1.6 Million Canadian Banking Records Shared with IRS," CBC News, Jan. 23, 2019, https://www.cbc.ca/news/politics/tax-fatca-u-s-canada-1.4988135?fbclid=IwAR1drQHaZGk-3gCPtt8oz44n0-j_Q6gpGOYNBuMYT8w_62xy9J4Zfg9yDw0, describing the Canadian government as recognizing that the consequences to the Canadian financial sector and the Canadian economy as a whole of failure to comply with FATCA are "potentially severe" and thus reasoning that if the enforcement of FATCA violates Canada's Charter of Rights, it is nevertheless a "reasonable limit on those rights given what was at stake."

[19] Karen Alpert, "Does FATCA stop tax evasion?" Fix the Tax Treaty, May 10, 2018, http://fixthetaxtreaty.org/2018/05/10/does-fatca-stop-tax-evasion/.

[20] Ibid.

[21] Treasury Inspector General For Tax Administration, "Despite Spending Nearly $380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance With the Foreign Account Tax Compliance Act," Reference Number: 2018-30-040, July 5, 2018, 1, https://www.treasury.gov/tigta/auditreports/2018reports/201830040fr.pdf (hereinafter, "TIGTA Report").

[22] "Offshore Voluntary Compliance Efforts Top $10 Billion; More Than 100,000 Taxpayers Come Back into Compliance," IRS, Oct. 21, 2016, https://www.irs.gov/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-compliance.

[23] Zhanna A. Ziering, and Benjamin Z. Eisensta, "Last Call for OVDP: Use it or Lose it," Bloomberg Tax, April 30, 218, http://www.capdale.com/files/23069_18tmm9ziering.pdf.

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[25] TIGTA Report.

[26] Byrnes, "Background and Current Status of FATCA and CRS,"1-5.

[27] Internal Revenue Service, " Foreign Account Tax Compliance Act International Compliance Management Model (ICMM) FATCA 4.1 Report Notification Technical Support Guide Version 3.0," June 2, 2016, 4, https://www.irs.gov/pub/fatca/fatcaicmmreportnotificationtechnicalsupportguidedraft.pdf.

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[29] Kyle Caldwell, "British Families Billed £500 – to Prevent Americans Dodging Tax," *The Telegraph*, Aug. 23, 2014, https://www.telegraph.co.uk/finance/personalfinance/tax/11050777/British-families-billed-500-to-prevent-Americans-dodging-tax.html.

[30] "#FATCA Denial of Service Library – Permanent Record," Citizenship Taxation, Feb. 12, 2018, http://citizenshiptaxation.ca/fatca-denial-of-service-library-permanent-record/.

[31] Lorie Konish, "More Americans are Considering Cutting Their Ties with the US — Here's Why," CNBC, June 30, 2018, https://www.cnbc.com/2018/06/27/more-americans-are-considering-cutting-their-ties-with-the-us-heres.html; "Business & Employment Issues," Citizenship Taxation, http://citizenshiptaxation.ca/business-employment-issues-staging/.

[32] Konish, "More Americans are Considering."

[33] "Our Stories of Renouncing/Relinquishing U.S. Citizenship," Citizenship Taxation, undated, http://citizenshiptaxation.ca/our-stories/.

[34] Examples of the difficulties Accidental Americans have faced in obtaining social security numbers: "Accidental American 'I Live Hell. I Had to Give up my Dual Nationality (i.e., Renounce My U.S Citizenship),'" Citizenship Taxation, undated, http://citizenshiptaxation.ca/accidental-american-i-live-hell-i-had-to-give-up-my-dual-nationality-i-e-renounce-my-u-s-citizenship/; CNN Wire, "Meet the 'Accidental American' Who Owes Taxes He Never Knew About," Fox4KC, Dec. 15, 2014, https://tribune.reaktivdev.com/2014/12/15/meet-the-accidental-american-who-owes-taxes-he-never-knew-about/; Ed Arbuckle, "Adventures of an Accidental American," *CastleMoore News*, Nov-Dec, 2012, 11, http://www.castlemoore.com/wp-content/uploads/2016/06/CM-LETTER-2012-11-12.pdf.

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[40] More specifically, the tax applies with respect to non-US companies when at least 50% of the company's shares are held by US persons. In this event, the tax applies with respect to each such shareholder that holds 10% or more of the company's shares. Todd C. Lady, "The New GILTI and Repatriation Taxes: Issues for Flowthroughs" *The Tax Adviser*, June 1, 2018, https://www.thetaxadviser.com/issues/2018/jun/gilti-repatriation-taxes-issues-flowthroughs.html; Melanie Chesir, "How Will the New Repatriation Tax Affect You? Philip Stein & Associates, Feb. 19, 2018, https://www.pstein.com/blog/will-new-repatriation-tax-affect/.

[41] Monte Silver, "The Repatriation Tax and the 962 Election," *The American*, July 16, 2018, http://www.theamerican.co.uk/pr/ea-Repatriation-Tax-962-Election.php.

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