Democrats Abroad Report on FBAR and FATCA Reporting Impacts: Proposing urgent, achievable reforms

Introduction

In 2011, the Democrats Abroad international Executive Committee appointed the FBAR/FATCA Task Force to examine the reporting mandates imposed on overseas Americans by the Foreign Bank Account Report ("FBAR" also known as Form TD-F 90-22.1) and the Foreign Accounts Tax Compliance Act ("FATCA"). Although the FBAR has been a reporting requirement to Treasury for many Americans[1] with bank accounts in foreign banks since 1972, it is only since 2004 that enforcement has escalated. FATCA was enacted by Congress in 2010 for the purpose of providing information to the IRS that it will use to identify and apprehend Americans making use of illicit schemes, structures, accounts and facilities to move untaxed earnings out of the U.S.[2]

This report contains four things:

1. A summary of the key provisions of FATCA
2. Democrats Abroad's position on FATCA
3. The impact of FATCA on Americans living outside of the U.S.
4. Democrats Abroad's Recommended Reforms

The Two Principal Provisions of FATCA

FATCA is a complicated piece of legislation and the way some of its provisions are interpreted is in constant flux. What follows is a summary of its two basic components.

1. Reporting Requirement for Foreign Financial Institutions (FFIs)
Most Foreign Financial Institutions—such as banks and brokerage houses—are required to enter into an agreement with the IRS to identify their U.S. account holders, disclosing their names, addresses and account details. Any U.S. financial institution making a payment to a non-compliant FFI must withhold 30% of the gross payment.

2. Reporting requirement for individual U.S. citizens and their families
A U.S. citizen living outside the U.S. must file the FATCA Form 8938 if he or she holds or has signatory control over funds in FFIs totaling $200,000 in aggregate at the end of the year or $300,000 in aggregate at any time during the year. The thresholds for couples filing jointly are $400,000 and $600,000, respectively. There are severe penalties for under-reporting income in any FFI. The thresholds for U.S.-based citizens are much lower and U.S. residents with signature power over jointly held overseas accounts may have to report even though the overseas citizen may not have to.[3]

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[1] Where Americans or U.S. Citizens are noted herein the terms also include Legal Permanent Residents/green card holders.

[2] This is how Wikipedia defines FATCA. "The Foreign Account Tax Compliance Act (FATCA) is a portion of the 2010 Hiring Incentives to Restore Employment (HIRE) Act. The FATCA requires individuals to report their financial accounts held outside of the United States, and requires foreign financial institutions to report to the Internal Revenue Service (IRS) about their American clients. FATCA was designed primarily to combat offshore tax evasion and to recoup federal tax revenues."

[3] IRS publication on FATCA: http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA). More details and copious references can be found in the Wikipedia on FATCA: http://en.wikipedia.org/wiki/Foreign_Account_Tax_Compliance_Act#cite_ref-17

Democrats Abroad Position on FATCA

Although Democrats Abroad supports strong policies to improve tax compliance and limit tax evasion, we Americans living abroad now find our financial lives exposed to a degree of scrutiny – under threat of severe penalties, fines and even imprisonment – to which Americans living stateside are not subjected. Implicit in this stringent reporting regulation is the unfair and unjustified suspicion that Americans living abroad are tax cheats and/or money launderers, which clearly the vast majority are not. The Task Force has been working for more than three years to outline to legislators and regulators the nefarious implications of FATCA compliance and to promote reforms that both preserve the law's intent and provide relief to law-abiding overseas Americans excessively burdened by it.

FATCA's Impact

Using evidence gained in a survey of our global membership - which generated thousands of responses - and a website to collect tax stories from overseas Americans, in addition to numerous inquiries, accounts and complaints from members around the world, Democrats Abroad has identified and documented FATCA's unintended adverse impact on overseas Americans. These are examples, in brief, of some of the issues raised by overseas Americans in addressing the challenge of meeting FBAR and FATCA compliance:

Impacts on employment opportunity:

- Discriminatory impact on U.S. senior managers in foreign companies where an American signature on corporate accounts triggers a reporting obligation to the IRS;
- Loss of job opportunities at all levels for Americans in multi-national corporations due to the cost of compensating for U.S. tax reporting;
- Weakening of entrepreneurial opportunities for overseas Americans due to onerous reporting obligations.

Impacts on personal affairs and privacy:

- Escalation in tax filing complexity and cost;
- Inability to open new financial accounts or forced closure of existing accounts;
- Assets and accounts held jointly with non-nationals subject to IRS scrutiny;
- Exorbitant and confiscatory penalties for non-compliance;

Democrats Abroad's Recommended Reforms

From our analysis of the data on the impact and our discussions with regulators, legislators and tax advisors, the Task Force established the following proposed reforms:

- Define a *foreign* or *offshore* account that must be reported as an account in a country other than one's country of residence, thereby recognizing our legitimate need for local banking services. This would also relieve the IRS of the burden and distraction of scrutinizing filings that detail legitimate overseas accounts;
- Raise the FATCA reporting threshold for overseas Americans to $1 million, therefore putting the focus on taxpayers with wealth that is sizeable enough to justify the costly and complex investment structures normally used to conceal assessable earnings;[4]

[4] We note that while Section 1010.350 (a) of the Code of Federal Regulations prescribes a reporting requirement to the Commissioner of Internal Revenue, and Section 5314 of the Code of Federal Regulations designates the prescribed form as the Report of Foreign bank and Financial Accounts (TD-F 90-22.1), the dollar amount that falls under said reporting requirement is nowhere designated.

- Index the reporting threshold to inflation so that it goes up every year just as the Section 911 income exclusion does;
- Add a provision that excuses anyone who does not owe taxes (because of the Section 911 Foreign Earned Income Exclusion or any other exemption or a tax treaty) from the obligation to file FATCA form 8983, regardless of the reporting threshold;
- Merge the FBAR reporting requirement with the developing FATCA legislation to eliminate duplication in filings;
- Offer true amnesty to overseas Americans who are delinquent taxpayers, inviting them to pay what they may owe and restore their status as tax-compliant citizens.

URGENT, ACHIEVABLE ACTION IS DEMOCRATS ABROAD'S PRIORITY

In the best of all possible worlds, the U.S. would have a policy of residency-based taxation rather than citizen-based taxation, and so foreign financial account reporting requirements established to catch tax cheats would focus exclusively on Americans who reside in the U.S. and shift untaxed earnings abroad. U.S. federal debt levels and funding needs suggest that it is not realistic to expect the U.S. Congress to give serious consideration to residency-based taxation in the near term nor for the IRS to ease up on its implementation of the law.[5]

Urgency in providing relief to overseas Americans is our highest priority.

Our efforts, and those of some non-partisan organizations of overseas Americans, over more than three years to lessen the adverse impacts of the law have yielded significant results. The FATCA threshold for all individuals was originally $50,000 —regardless of where they lived. Democrats Abroad and others lobbied successfully to get the threshold raised for overseas Americans to the $200,000/$400,000 thresholds noted in the first section.[6]

Our on-going advocacy plan will continue to focus on reforming the regulations established by the IRS and Treasury because we are confident that **our reforms are achievable in the short run and will be effective.**

Democrats Abroad will continue to provide full-throated support to strong, good faith efforts to block and catch Americans using illegal means to avoid paying taxes; we will also continue to urge the government to recognize that most overseas Americans are honest citizens, not tax cheats or money launderers.

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[5] See Bloomberg reporting this on 6 January 2014. "Newly confirmed Internal Revenue Service Commissioner John Koskinen said some of the top priorities for his office include improving compliance, ensuring the IRS has enough money as part of the budget process, building employee morale and working to restore the public's trust in the wake of controversy.

Speaking to reporters during a 45-minute meeting Jan. 6, Koskinen said implementing both the Affordable Care Act and the Foreign Account Tax Compliance Act are key goals, with FATCA expected to provide a significant amount of information to help the IRS fight offshore tax evasion.

It symbolizes 'the increasing capacity of the IRS and the U.S. to be able to track down offshore accounts and those who have been avoiding income taxes,' Koskinen said. FATCA is expected to be a big step forward in tax compliance, he said."

[6] Republicans Abroad has been conspicuous by their absence in lobbying for reforms to FATCA. Political operatives at the RNC have woken up to the issue and have formed a new entity called Republicans Overseas to make political capital out of a FATCA repeal effort. They hope the movement will stir sentiment and drive overseas votes to Republican candidates and raise money. Their plan is at best quixotic and at worst a blatant political ploy – in either case it is likely to fail given the commitment that regulators have demonstrated to implementing the law and the recognition in the U.S. and globally that tax dodging must be stopped.