

American Citizens Abroad

The Voice of Americans Overseas

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The FBAR SCAM

American Citizens Abroad (ACA), the Voice of Americans Overseas, is calling for all Americans who are bona fide overseas residents to be exempted from filing the Foreign Bank Account Report (FBAR).

The FBAR reporting is an annual requirement to file with the Department of Treasury by June 30th a statement of the financial assets owned overseas during the prior year.

In recent years, in the hands of the IRS enforcers, the FBAR has become a discriminatory tool aimed at one group of U.S. citizens, those residing overseas, subjecting them to penalties out of all reasonable proportion.

Americans residing overseas find themselves in the crossfire of a raging battle between IRS enforcers and U.S. residents with undeclared assets hidden abroad. Americans residing overseas are not part of the issue and should be exempted from the FBAR requirement, to the extent that they are bona fide overseas residents, under the IRS definition.

ACA position on FBAR

ACA specifically urges Congress to amend 31 U.S.C. §5314 as follows:

- Specify that Americans who are bona fide residents overseas be exempt from the FBAR filing requirement for accounts in which one has a financial interests as well as accounts over which one has only signatory authority. This would significantly reduce the total number of filings and would allow the IRS to focus on actual cases of abuse: wealthy Americans resident in the United States hiding assets and income in foreign bank accounts as well as organized criminals, drug dealers, money launderers and terrorists.
- Eliminate for bona fide overseas residents the civil and criminal penalties for past non-willful and willful FBAR filing noncompliance. This would encourage those abroad who have not been filing their U.S. tax returns to enter the system and pay any back taxes due and penalties related to those taxes due.
- Reduce the maximum penalties for both civil and criminal offenses so that the penalties are not confiscatory but fall within the constitutionality of the 8th Amendment.

- Raise the reporting threshold from \$10,000 to \$250,000.
- Apply, instead of June 30, the same due date as for normal tax filing, i.e. April 15, and the same dates for extensions allowed for tax filing.
- Accept the postmark date to determine that an FBAR has been filed in a timely way, rather than the date of reception, which is beyond the control of the filer.
- Allow the existence of reasonable cause to waive late filing penalties versus imposition of automatic \$10,000 willful minimum penalty.

In addition, ACA also strongly recommends a GAO review of FBAR administration and effectiveness, as detailed below.

Historical background

U.S. Treasury Form TD F 90-22.1, commonly known as the FBAR (Foreign Bank Account Report) is to be filed annually by all U.S. residents and citizens having a financial interest in, or signature authority over, bank, securities or other financial accounts in a foreign country if the total value of the assets exceeds \$10,000. This reporting requirement was initiated with the Bank Secrecy Act of 1970 under 31 U.S.C. §5314.

The law was originally passed to have the legal means to pursue organized criminals, drug dealers, money launderers, tax evaders and other criminals. For more than 30 years, it was essentially dormant. Only a handful of cases were prosecuted. Following 9/11, Congress broadened the purpose of the Bank Secrecy Act under the Patriot Act “to expressly state that the FBAR is vital to the U.S. government not only in carrying out criminal and tax investigations, but also in conducting intelligence activities to protect against international terrorism.”¹ In 2003 the Treasury Department transferred the administration of the FBAR from FinCEN to the IRS, thereby emphasizing its role to track down tax evasion through use of foreign financial accounts. In 2004, with the passage of the American Jobs Creation Act (AJCA), Congress reinforced the position of the IRS by increasing the penalties applicable for non-filing of the FBAR. The stated aim was to go after wealthy U.S. residents hiding money overseas and not reporting the income on those assets. It is one of the tools aiming to close the “tax gap” and is being used as a source of revenue.

Americans residing overseas by definition have foreign bank accounts and other foreign financial assets as well as real estate overseas, just as people living in Kansas use banks in Kansas and have homes in Kansas. Americans resident overseas pay taxes in their country of residence, and the United States allows foreign tax credits against U.S. tax liabilities as it recognizes the primary right of taxation in the country of residence. Their situation is totally different from that of Americans resident in the U.S. who are deliberately hiding assets abroad to evade taxes. Having foreign financial assets is a necessary part of life for Americans abroad. Most Americans abroad are long-term overseas residents and consequently have the majority, if not all, of their assets overseas. This is significantly different from the wealthy U.S. resident who hides just part of assets overseas in foreign financial accounts.

Since 2009, the aggressive approach of the IRS in administering its new mandate has created a major scam. Upon reaching a settlement with UBS whereby the bank turned over 4,450 American accounts to the IRS, the IRS used the massive publicity surrounding this tax evasion case to promote a fear campaign to increase the number of FBAR filers and to simultaneously introduce the 2009 OVDP (Overseas Voluntary Disclosure Program), which was presented as an advantageous and flexible way to enter the filing program during a limited period of time from March through October 2009. Once in the program, processing of the file could take one to two years.

Via the OVDP, the IRS has "gone fishing", entangling thousands of honest middle class, tax-paying Americans overseas in a vast net, as many of them were unaware of the FBAR reporting requirement. While there is nothing illegal about having foreign bank accounts, the IRS enforcement of the FBAR filing has treated those who have not filed the FBAR as criminals, lumping ordinary Americans with the same group of drug dealers and organized criminals. The penalties for not filing the FBAR are confiscatory, arguably anti-constitutional under the 8th Amendment, which states "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." Furthermore, the IRS used a "*Bait and Switch*" tactic², with the 2009 OVDP (see below), which is immoral and unethical.

About 15,000 people participated in the 2009 OVDP, many of them Americans residing overseas under the assumption, as stated in the published guidelines of 2009 OVDP, that under no circumstances would a taxpayer be required to pay a penalty greater than he or she would otherwise be liable for under existing statutes. Under the existing statutes, a *non-willing* violator (a person who was simply not aware of the filing obligation) would have to pay tax and be subject to a maximum penalty of \$10,000 for not filing the FBAR. Citizens who owed no taxes but who failed to file an FBAR would not be subject to penalty application. Many who entered the system expected minimal penalties related to non-filing of the FBAR as they owed little or no tax to the U.S. and the IRS internal guidelines called for discretion in issuing penalties.

In March 2011, 18 months after the end of the period for entering the OVDP, the IRS retroactively changed the rules of the OVDP and stated that all cases would be treated as *willful* violators – hence the term "*Bait and Switch*". Those who entered the program in good faith as *non-willful violators* "could either agree to pay more than they believed they owed or withdraw from the 2009 OVDP and face the possibility the IRS would assert massive civil penalties and seek criminal prosecution."³ Under these rules, the OVDP systematically imposed a penalty amounting to 20% of the highest balance in the foreign accounts for each of the six years from 2003 to 2009. The IRS also specified that any account linked to the servicing of real estate would be subject to the inclusion of the valuation of that real estate in calculating the penalties (i.e. 20% of the value of the real estate). This was presented as a "deal" because the law allows for maximum penalties of 50% of overseas assets for every year of noncompliance.

In early 2011, the IRS initiated its second voluntary disclosure program 2011 OVDI (Overseas Voluntary Disclosure Initiative), which was to run up to August 31st 2011, subsequently prolonged to September 9th due to Hurricane Irene. The OVDI made clear that the original standard 20% penalty under the 2009 program would now become 25% of foreign assets in addition to any back taxes due and penalties

related to taxes. In announcing the program, the IRS raised the threat of criminal prosecutions and jail sentences if individuals tried to simply begin filing the FBAR quietly under normal filing procedures and not enter into the OVDI, which as with the OVDP, was operated under the Criminal Investigations unit of the IRS.

The IRS cleverly publicized cases it won and let it be known that the 4,450 UBS cases and the 15,000 filers under the OVDP had provided the IRS with vast information related to structures overseas aiming to hide assets and that the IRS would be going after non-filers. Another 15,000 tax filers participated in the OVDI program, giving a total of 30,000 taxpayers who entered under the voluntary disclosure programs. The IRS proudly announced in its press release of September 15, 2011 that the OVDP had already brought in \$2.2 billion in revenue with 80% of the cases closed and that the OVDI had brought in \$500 million, an amount which was bound to increase as penalties were still to be collected. Commissioner Schulman was quoted: “Not only are we bringing people back into the U.S. tax system, we are bringing revenue into the U.S. Treasury and turning the tide against offshore tax-evasion.” He took the opportunity to reinforce the scare tactics of the IRS. “The dollar figure will grow in the months ahead. But just as importantly, we have changed the risk calculus. Americans now understand that if they try to hide assets overseas, the chances of being caught continue to increase.”⁴

Perhaps the most egregious offense by the IRS was counseling individuals who had simply forgotten to file FBAR but who owed no taxes, to enter into the ODVP program. The IRS guidelines stated that if an individual had simply been negligent in filing the FBAR but owed no taxes on that income then they were to simply file “back” FBARs. However many of these individuals when requesting guidance from the IRS on their situations were encouraged to enter ODVP and once in were bound by the regulations. The provision for no penalties if no back taxes were owed – initially included in the ODVP guidelines – was quietly removed, thereby entrapping those who entered in good faith. (See cases below)

The Taxpayer Advocate Service (TAS) announced in its June 30, 2011 report its sharp criticism of the IRS tactics. “Pressuring taxpayers who would pay less under existing statutes to remain in the program and pay more than they believe they owed was even worse. It violated longstanding IRS policy along with most conceptions of fairness and due process. The IRS’s inconsistency and failure to follow its published guidance damaged its credibility with practitioners and could be subject to legal challenge.”⁵

Abused taxpayers - Testimonies from overseas Americans

ACA has received numerous testimonies from abused taxpayers who entered the OVDP. Four cases have been highlighted here as particularly disturbing, illustrating the human drama resulting from the rigidity and excessive penalties of the IRS.

- **An American in Germany:** An American citizen who has lived in Germany for 32 years had no idea she had to file U.S. taxes until 2009. She owed no U.S. taxes. To correct the situation she filed back years and also filed the FBAR forms. In late 2009 she learned of the IRS OVDP and read the very confusing FAQ 9 which said one should not submit a voluntary disclosure if one did not owe any tax but had merely not filled out the FBAR form. Q10, on the other hand, explained that the type of filing she had done was “quiet disclosure” and threatened criminal prosecution

for not turning it into a “noisy disclosure”. She decided to err on the side of caution and entered the OVDP. “What a mistake that was, expecting fairness from the IRS! The IRS concluded that I did not owe any tax, but it nevertheless asked for the maximum non-willful penalty, which corresponds to 8 months take-home pay.” Her story was featured in a recent article in the *Financial Times*, “Tax Compliance Bill Drives Expat to Despair of US”; June 12, 2011.

- **An American in Switzerland:** “I am fairly typical of dual citizens living outside the U.S. since 1980. I’ve been trying now for over a year to become compliant, not having realized like almost everyone here that I needed to file FBARs for past years...I have to pay someone at least a couple thousand francs to do it for me, even though I have not owed any U.S. taxes for years and have always filed and paid Swiss taxes. This is simply sick, and for a family that struggles financially...I see no reason at all to remain an American...There is a moral dilemma here.”
- **An American executive who worked overseas for much of his career for a company with international operations:** “I held financial accounts and most all of the income with respect to my foreign accounts was disclosed on my 1040s. However, in a review conducted by my accountant it was discovered that not all of the income was reported correctly, nor did we file the necessary FBAR forms (TD F 90-22.1). I decided to enter the voluntary disclosure program, spending about \$60K in professional and legal fees. I have filed the FBARs for the past six years and amended all of my tax returns. The net impact of the changes is that I am now due a refund of under \$500 from the IRS and my adjusted gross income over the past six years changed by less than 1% -- almost zero.

“Furthermore, the income earned on the foreign accounts, was already recognized on the original 1040 returns filed timely and the amended returns actually reduced this amount due to offsetting items. In other words, I reported more than 100% of all the foreign income already on my original 1040 tax returns. However, the IRS is deeming my failure to file the FBARs and fully disclose my accounts as “willful”. Either I am subject to huge penalties – which I am advised could exceed \$5 million, or, alternatively, I can stay in the “Amnesty Program” which was launched last year and pay a fine of 20% of the highest balance over the past six years, which in my instance will be more than a \$1,000,000.”

- **American in Denmark:** “I am an average American-born citizen who married a Dane and moved to Denmark. I was unaware that I was supposed to file a form telling the IRS of a bank account I opened here in Denmark to deposit my meager income from my Danish employer. Not only am I to report my bank account but also all other accounts, including pension and retirement accounts. I was hunted down by the IRS and harassed for living overseas but not claiming a foreign bank account. It’s become overwhelming and intrusive. I am now considering giving up my U.S. citizenship as I can honestly say that this abuse of the IRS and government power is not what America is supposed to be about...These regulations have now lost all sense of logic and reason and have been used to harass average citizens living and working abroad trying to make a simple living. It’s becoming abusive.”

Several Canadian newspapers have mounted a verbal assault on the U.S. tax practices with personal testimonies of the fiscal drama imposed by the OVDI and the FBAR scam. One testimony in the *Vancouver Observer* reflects the dilemma facing thousands of Canadian-Americans.

“Several weeks ago, my brother sent me an article from the Financial Post – and my life changed in an instant. My brother and I were born in the United States but left as teens. I have lived and worked in Canada for close to the last four decades, as a proud Canadian citizen....In its supreme arrogance, because our neighbor to the south is broke and in considerable debt, it is now bullying folks like me, by laying down the law saying that *all* of its citizens must pay U.S. taxes, regardless of the circumstances. And if any non-resident citizens choose to be ‘non-compliant’ and not file up to several years of back taxes, they could be punished by facing stiff fines of up to 25% of their entire financial net worth, and maybe even go to jail. The jackbooted tone of the warning was clear. The IRS meant to scare – and it worked...

“For the past 38 years, living and working in Canada, I have gladly supported my country financially with my tax returns every year. Never once have I been ‘non-compliant’...

“I am but a number in this complex cog, this blatant tax grab. I am so furious with the U.S. that I now want to renounce my citizenship. But guess what? There’s another Catch-22. In order to renounce my citizenship, I have to pay *at least* 6 years of back taxes. It’s Orwellian.”⁶

The law discriminates against Americans overseas

It is necessary to put this issue in perspective. The FBAR is just the requirement to file a statement of one’s foreign financial assets. It has nothing to do with tax filing obligations. It is just an informational report whose utility can be questioned. For thirty years, it was largely ignored by the Department of Treasury as well as professional tax preparers and taxpayers. Up to 2003, there was no penalty for non-willful noncompliance. When an American abroad learned of the FBAR filing requirement, he or she just began to file under the normal procedure. Since 2004 with the introduction of confiscatory penalties, the IRS has turned the law into a revenue generator for the U.S. government. The law has certainly gone astray from its original purpose by treating honest individuals as criminals. Under FBAR, one is guilty until proven innocent.

The law is particularly discriminatory against Americans residing overseas because they must have foreign financial assets to survive and in fact have most of their assets overseas. Additionally many of the instruments that the IRS considers a bank account to be disclosed include pension funds and insurance policies that because of their nature are difficult to quantify. However, there is no guidance from the IRS in determining these and therefore someone could be fined simply for ignorance.

The fines by their very nature are anti-egalitarian as they have no relationship to income and are completely out of proportion to the error committed, seriously threatening an individual’s financial security and solvability. The maximum penalty of 50% of assets for every year of the statutory limit can amount to 300% of total assets of an American abroad who has all of his or her savings overseas. In

contrast, a wealthy American residing in the United States who hides 10% of his wealth in a foreign bank account deliberately to avoid paying taxes would lose a maximum of 30% of his wealth.

Who are the Americans residing overseas? They are far from a homogeneous group and certainly do not correspond to the stereotype image held in the United States that Americans abroad are all wealthy tax cheaters. The latest estimate of the State Department is that there are 6.3 million Americans abroad, although no detail is provided by country of residence.

- A recent survey of U.S. overseas voters found that 83% classified themselves as living overseas indefinitely or permanently.⁷
- 68% have salaries below \$85,000; 22% have salaries between \$85,000 and \$200,000 and 10% have salaries exceeding \$200,000.⁸
- Many Americans abroad, in fact, have no contact with the United States; they were born in the U.S. of foreign parents who later returned to their home country or they were born abroad of an American parent and a foreign parent and have lived their entire lives overseas.
- Many have lived all of their adult lives abroad as they married a foreigner. Half of those who describe themselves as permanent overseas residents gave marriage as the reason for living abroad.
- Others overseas have had careers split between the United States and their country of residence overseas where they reside on a long-term basis.
- Some are university students earning minimal or no income.
- Finally, some American retirees settle overseas in warmer climates and in countries with lower cost of living either permanently or for several months a year.
- Americans living abroad are law-abiding individuals who pay taxes where they reside. The great majority lives in countries with high tax personal tax rates and heavy indirect taxes. As the country of residence has first right to tax, most overseas Americans owe little or no U.S. tax. Many, in fact, ignore the need to file U.S. taxes as they do not live in the IRS environment of the United States.

The IRS September 15, 2011 press release stated: “These cases come from every corner of the world, with bank accounts covering 140 countries.”⁹ While the IRS has not specified how many of the participants were bona fide overseas residents, the large number of countries mentioned strongly suggests that many participants were Americans residing abroad, particularly since Commissioner Schulman referred to “bringing people back into the U.S. tax system.” A program intended to go after wealthy tax cheats residing in the United States has turned into devastation of middle-class Americans residing overseas. By extending vigorous FBAR enforcement to Americans residing overseas, the IRS has singled out a specific group of U.S. citizens for discrimination. The IRS has created an insoluble dilemma. Those currently not filing will face financial ruin if they enter the system as most have all of their assets

overseas, including real estate. And in 2008, “The U.S. District Court determined in *Simonelli* that the FBAR penalty was not a ‘tax’ or ‘tax penalty’ that could be discharged in bankruptcy.”¹⁰ These excessive penalties will not encourage compliance.

ACA urges those Americans resident overseas who believe that they have been excessively penalized under the OVDP and OVDI to apply for recourse through the Taxpayer Advocacy Service (TAS). TAS has already remedied certain cases. As tax lawyer Jack Townsend stated in his blog, “TAS can intermediate differences between the IRS and the taxpayer regarding seemingly rigid application of OVDP 2009 and OVDI 2011, thereby producing harsh results. The TAS may also play a role in opt out where the fear is that the IRS will be punitive and in audits for taxpayers, who never joined either initiative where the same fear exists.”¹¹ Another tax lawyer, Phil Hodgen, concurs: “When you come up against the wall at the end of the process, and the penalty is in Over-the-Top category for the minor transgression; and you are in disagreement with your agent on willfulness, you might consider an appeal to the Tax Advocacy Service for help before either Opting Out or being forced out. Again, and I emphasize, that could only happen at the very end of the process.”¹²

In certain cases, opting out appears to be best approach. Phil Hodgen cited an example: “I have one guy who has \$77 of extra tax over six years and the IRS wants almost \$800,000 of penalties. We’re opting him out. Of course!”¹³

ACA strongly recommends a GAO review of the IRS administration of the FBAR

- Determine how many participants in the OVDP and the OVDI are Americans resident overseas versus U.S. residents
- Determine what proportion of the total revenue collected by the IRS relates to a) unpaid taxes b) accuracy penalty on unpaid taxes c) penalty based on asset values for not filing of the FBAR or other reports
- Review the purpose and usefulness of the entire FBAR filing program: Does it help locate money launderers, drug money, mafia money and terrorists? What is the cost to the IRS of administering the FBAR, including handling 600,000 files annually, the legal staff writing up regulations and FAQs, agents dealing with the cases under OVDP and OVDI?
- Question the utility of the new IRS form 8938 under the FATCA legislation that requires Americans with foreign financial assets to list them and file this form with the 1040 starting with fiscal year 2011. This new form will, as with the FBAR, severely impact Americans residing abroad who by definition have foreign financial assets, subjecting them to another set of discriminatory penalties. It creates double reporting with the FBAR, but with different rules, and the complexity will significantly increase the cost of tax filing compliance. It is so complicated that one and a half years after passage of FATCA, the IRS has yet to produce the instructions for completing the draft form 8938. Will this additional filing bring in enough additional tax revenue to justify the administration cost to the IRS?¹⁴

Conclusion

The Bank Secrecy Act must be amended to stop this rampant abuse of law-abiding American citizens. ACA urges Congress to act rapidly before more innocent Americans are snared in the system.

September 16, 2011

Footnotes:

¹ Hale E. Sheppard, "Evolution of the FBAR: Where We Were, Where We Are, and Why it Matters", published in Houston Business and Tax Journal, 2006, p. 2-3.

² The term "Bait and Switch" was coined by Jack Townsend, Jack L. Townsend, Sr. P.A., Attorney at Law, Tampa, Florida, 33617, on his blog: <http://federaltaxcrimes.blogspot.com/2011/06/taxpayer-advocate-criticizes-irs.html>

³ http://www.irs.gov/pub/irs-utl/fy2012_ntaobjectives.pdf The Taxpayer Advocate Service Report to Congress on its Fiscal Year 2012 Objectives (6/30/2011). K "IRS's Inconsistency and Failure to Follow Its Published Guidance Damaged Its Credibility With Practitioners Involved in the Offshore Voluntary Disclosure Program, p. xxxiv

⁴ IR-2011-94, September 15, 2011. « IRS Shows Continued Progress on International Tax Evasion" irs@service.govdelivery.com

⁵ Ibid.

⁶ Candace Platter, "Get out of my pocket, Uncle Sam", Vancouver Observer, September 9, 2011 <http://www.vancouverobserver.com/blogs/publishersplatform/2011/09/09/get-out-my-pocket-uncle-sam>

⁷ Overseas Vote Foundation, 2010 OVF Post Election UOCAVA Survey Report and Analysis https://www.overseasvotefoundation.org/files/OVF_2010_Post_Election_Survey_Report.pdf p. 9

⁸ IRS statistics: Individual Income Tax Returns with Form 2555 for the year 2006. <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96621,00.html> These IRS statistics provide only a partial picture of income of residents abroad as many U.S. citizens resident overseas do not use Form 2555 which allows the foreign earned income exclusion, but apply only foreign tax credits with Form 1116. The IRS does not provide data which distinguishes overseas residents from U.S. residents for filers of Form 1116.

⁹ Op.cit., IR-2011-94, September 5, 2011. "IRS Shows Continued Progress on International Tax Evasion"

¹⁰ Hale E. Sheppard, « Two More Blows to Foreign Account Holders: Tax Court Lacks FBAR Jurisdiction and Bankruptcy Offers No Relief from FBAR Penalties", Journal of Tax Practice & Procedure, February-March 2009, p. 44-45.

¹¹ Jack Townsend's blog: <http://federaltaxcrimes.blogspot.com/2011/08/taxpayer-advocate-service-to-smooth.html>

¹² Phil Hodgen blog's on FBAR, August 27 2011, <http://www.hodgen.com/phils-blog/>

¹³ Philip D. W. Hodgen, Hodgen Law Group PC, Pasadena, CA 91011. www.hodgen.com

¹⁴ For more on FATCA, ACA's position paper calling for the repeal of FATCA can be found at <http://www.aca.ch/fatcapp.pdf>