

# COMMENT

## GOODBYE, UNCLE SAM? HOW THE FOREIGN ACCOUNT TAX COMPLIANCE ACT IS CAUSING A DRASTIC INCREASE IN THE NUMBER OF AMERICANS RENOUNCING THEIR CITIZENSHIP\*

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## I. INTRODUCTION

Eduardo Saverin, a resident of Singapore, renounced his U.S. citizenship shortly before Facebook's initial public offering in order to lessen his tax liabilities.<sup>1</sup> Saverin benefitted greatly by dropping his U.S. citizenship at that time.<sup>2</sup> After renouncing, only income he earned within the United States would be taxed, and it would be taxed at a lower rate than if he was an American citizen.<sup>3</sup> However, Eduardo Saverin is just one of many Americans who took the drastic step of renouncing their citizenship to avoid paying U.S. federal income taxes.<sup>4</sup>

While high-profile cases of celebrities or other famous people renouncing their citizenship catches the public's attention, a vast majority of the Americans living abroad affected by these harsh taxation and filing rules are middle-class or retired.<sup>5</sup> Not surprisingly, many American citizens living abroad are choosing to give up their U.S. citizenship given that taxpayers will

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1. Brian Solomon, *Eduardo Saverin Renounces U.S. Citizenship Ahead of Mega Facebook IPO*, FORBES (May 11, 2012, 1:08 PM), <http://www.forbes.com/sites/briansolomon/2012/05/11/eduardo-saverin-renounces-u-s-citizenship-ahead-of-mega-facebook-ipo/>. Tina Turner, who has lived in Switzerland for over two decades, is another example of a high-profile American citizen who renounced her American citizenship recently. Al Kamen, *From Proud Mary to Swiss Miss*, WASH. POST, Nov. 13, 2013, at A15.

2. Solomon, *supra* note 1.

3. 26 U.S.C. § 871(a)(1) (2012); Solomon, *supra* note 1.

4. See Laura Saunders, *Overseas Americans: Time to Say 'Bye' to Uncle Sam?*, WALL ST. J. ONLINE (Aug. 17, 2013, 5:20 PM), <http://online.wsj.com/news/articles/SB10001424127887323455104579014772169287210> (describing the high number of Americans renouncing their citizenship recently).

5. Helena Bachmann, *Mister Taxman: Why Some Americans Working Abroad Are Ditching Their Citizenships*, TIME (Jan. 31, 2013), <http://world.time.com/2013/01/31/mister-taxman-why-some-americans-working-abroad-are-ditching-their-citizenships/>.

generally do whatever is necessary to exploit legal means available in order to achieve a lower tax bill.<sup>6</sup>

As of July 1, 2014, when the Foreign Account Tax Compliance Act (FATCA) went into effect, Americans living abroad faced increased reporting burdens and tax obligations.<sup>7</sup> The purpose of FATCA is “to catch non-compliant U.S. taxpayers with funds located abroad.”<sup>8</sup> The Act might be responsible for many overseas Americans choosing to renounce their citizenship,<sup>9</sup> despite the harshness of renouncing one’s citizenship.<sup>10</sup> Record numbers of American citizens gave up their citizenship in 2013, more than tripling the number of citizens who renounced in 2012.<sup>11</sup>

In order to slow down the rate of Americans renouncing their citizenship, as well as make life better for U.S. persons<sup>12</sup> living abroad, FATCA needs to be repealed or, at a minimum, drastically amended.<sup>13</sup> Because of the strict reporting requirements placed upon foreign financial institutions,<sup>14</sup> many of them have begun denying services, such as savings accounts

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6. See *Gregory v. Helvering*, 293 U.S. 465, 469 (1935) (“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.”).

7. Foreign Account Tax Compliance Act, Pub. L. No. 111-147, §§ 501–562, 124 Stat. 71, 97–118 (2010) (codified in scattered sections of 26 U.S.C.); K&L Gates LLP, *The Price of Leaving: Renouncing U.S. Citizenship Comes with Costly Consequences*, JDSUPRA BUS. ADVISOR (Aug. 28, 2013), <http://www.jdsupra.com/legalnews/the-price-of-leaving-renouncing-us-ci-04223/>.

8. K&L Gates LLP, *supra* note 7.

9. Robert W. Wood, *Americans Renouncing Citizenship Up 221%, All Aboard the FATCA Express*, FORBES (Feb. 6, 2014, 10:57 PM), <http://www.forbes.com/sites/robertwood/2014/02/06/americans-renouncing-citizenship-up-221-all-aboard-the-fatca-express/>. Although there are often many reasons for someone to renounce their citizenship, the complex and costly tax filing can be a deciding factor. *Id.* Statistics for why people leave the United States are not available, but many Americans see the tax compliance and disclosure laws of the United States as “inconvenient and nettlesome.” *Id.*

10. See discussion *infra* Part III.A (discussing the harshness of renouncing one’s U.S. citizenship).

11. Wood, *supra* note 9. The total number of renunciations for 2013 was 2,999, while in 2012 it was only 932. *Id.* Previously, 2011 had the record high with 1,781 citizenships dropped. *Id.*

12. *Classification of Taxpayers for U.S. Tax Purposes*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Individuals/International-Taxpayers/Classification-of-Taxpayers-for-U.S.-Tax-Purposes> (last updated May 28, 2014) (defining “U.S. person” as a citizen or resident of the United States, a domestic partnership or corporation, a nonforeign estate, certain trusts, and any other nonforeign person).

13. See discussion *infra* Part V (exploring potential solutions to the FATCA problem).

14. The definition of “foreign financial institution” is broad, including any non-U.S. entity engaged in banking, investing, or the holding of assets. 26 U.S.C. § 1471(d)(4)–(5) (2012). This broad definition is not just for banks and presumably extends to hedge funds, foreign pension funds, and similar entities. See *id.*

and home mortgage loans,<sup>15</sup> to American customers in order to avoid having to comply with FATCA.<sup>16</sup> In addition, the individual reporting requirements call for Americans living abroad to fill out extra forms when filing their taxes, even when no tax is due.<sup>17</sup> This may necessitate the hiring of an accountant or tax expert in order to comply with these requirements, which can be quite expensive.<sup>18</sup>

This Comment will focus on the taxation of American citizens living abroad, their limited options regarding taxes, the harsh effects of FATCA on such persons' lives, and the potential changes to FATCA that would mitigate its harsh effects. Part II discusses Americans living abroad generally and what their tax burdens and reporting obligations are. Part III focuses on the act of expatriation and renouncing one's citizenship, and the resulting tax liability that goes along with renouncing. Part IV argues that taxing Americans living overseas on their worldwide income is unfair and that FATCA will do much more harm than good. Finally, Part V explores potential solutions that the U.S. government should consider in repealing or altering the act or taxation of Americans living abroad in general.

## II. INCOME TAX BURDENS ON AMERICANS LIVING ABROAD

### A. *What Makes the United States Different?*

The United States is unique in that it is the only industrialized country in the world to tax its citizens on all

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15. Buying a home can be a very important financial decision because buying a primary residence, whether it is in the United States or a foreign country, entitles the American buyer to certain tax benefits, including deductions for mortgage interest and property taxes. Chad Creveling & Peggy Creveling, *Expat Americans: What You Need to Know Before Buying a Home Overseas*, CREVELING & CREVELING PRIVATE WEALTH ADVISORY (Sept. 9, 2013), <http://www.crevelingandcreveling.com/blog-list/173-expat-americans-what-you-need-to-know-before-buying-a-home-overseas.html>. Additionally, Americans overseas buy homes for nonfinancial reasons, often attempting to create a stable and permanent environment for their family or feel a connection with the local community. *Id.*

16. Victoria Ferauge & Lynne Swanson, *FATCA Losing Its Way*, ACCT. TODAY (Sept. 11, 2013), <http://www.accountingtoday.com/news/FATCA-Losing-Way-68007-1.html>; *see Unintended Consequences: The REAL Impact of the Foreign Account Tax Compliance Act*, ASS'N AMERICANS RESIDENT OVERSEAS, <http://www.aaro.org/87-position-papers-2011/312-fatca> (last visited Feb. 4, 2015) [hereinafter *Unintended Consequences*]; *see also* discussion *infra* Part IV.C.2 (identifying the various ways FATCA will make living a normal life overseas more difficult for many Americans).

17. *See Overtaxed and Over There*, ECONOMIST, Oct. 12, 2013, at 38, 38; Saunders, *supra* note 4 ("Paying lawyers and accountants to help meet the various reporting and filing requirements routinely costs at least \$1,000 a year, and often much more.")

18. Saunders, *supra* note 4; *see* discussion *infra* Part IV.C.2 (discussing the expense associated with the complicated FATCA reporting requirements).

income earned, regardless of where it is earned.<sup>19</sup> All other countries tax their citizens based on residency.<sup>20</sup> In other words, most countries do not tax the foreign-earned income for its citizens living abroad, but rather they tax their citizens only on the income earned within the home country.<sup>21</sup>

The problem with taxing all U.S. persons on their worldwide income is exacerbated by the expansive definition of American citizenship.<sup>22</sup> This is largely due to the *jus soli* component of the U.S. citizen law, which provides for anyone born on American soil to be a U.S. citizen, even if their parents are not American citizens.<sup>23</sup> Additionally, the corresponding *jus sanguinis* component allows for children born to American citizens on foreign soil to be eligible for citizenship if the parents meet certain requirements.<sup>24</sup>

As a result, there are many “accidental Americans” around the world because it is not always obvious that a given person is a U.S. citizen.<sup>25</sup> All of these “U.S. persons” are expected to file a tax return with the Internal Revenue Service (IRS).<sup>26</sup> Furthermore, reporting rules under FATCA will affect many

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19. See Robert W. Wood, *Expats Lobby for Tax on Residence, Not Worldwide Income*, FORBES (Feb. 25, 2012, 6:35 AM), <http://www.forbes.com/sites/robertwood/2012/02/25/expats-lobby-for-tax-on-residence-not-worldwide-income/> (“The U.S. is the only industrialized country in the world to impose citizenship-based taxation.”). Eritrea is an example of a nonindustrialized country that imposes a worldwide income tax. See U.S. DEPT OF STATE, 2013 HUMAN RIGHTS REPORTS: ERITREA (2014), available at <http://www.state.gov/j/drl/rls/hrrpt/2013/af/220111.htm> (describing Eritrea’s 2% tax on worldwide income for all Eritrean citizens).

20. See David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, N.Y. TIMES, Dec. 27, 2011, at B1 (referring to the United States as the only developed country in the world to tax its citizens on their worldwide income).

21. John D. McKinnon, *Tax History: Why U.S. Pursues Citizens Overseas*, WALL ST. J. BLOG (May 18, 2012, 4:39 PM), <http://blogs.wsj.com/washwire/2012/05/18/tax-history-why-u-s-pursues-citizens-overseas/>; Wood, *supra* note 19.

22. U.S. CONST. amend. XIV, § 1.

23. *Id.*; see Joe Costanzo & Amanda Klekowski von Koppenfels, *Counting the Uncountable: Overseas Americans*, MIGRATION INFO. SOURCE (May 17, 2013), <http://www.migrationinformation.org/Usfocus/display.cfm?id=951> (describing situations where children born on American soil to migrant workers, foreign employees of businesses in the United States, or international students become American citizens).

24. See Costanzo & von Koppenfels, *supra* note 23 (explaining requirements for the *jus sanguinis* component).

25. Colleen Graffy, Op-Ed., *A Special Tax Misery for Americans Living Abroad*, WALL ST. J. ONLINE (July 17, 2013, 7:26 PM), <http://online.wsj.com/news/articles/SB10001424127887323993804578611711520269422>.

26. 26 U.S.C. § 911 (2012); see Victoria Ferauge & Lynne Swanson, *FATCA: ‘Simple Premise’ Gone Terribly Wrong*, HILL (July 28, 2013, 1:00 PM), <http://thehill.com/blogs/congress-blog/foreign-policy/313775-fatca-simple-premise-gone-terribly-wrong> (“Even the King of Thailand, the Mayor of London, England and the Premier of the Canadian province of New Brunswick are considered ‘U.S. persons’ under American law simply because they were born in the United States.”).

people who may not realize they have a duty to report to the U.S. government.<sup>27</sup> In order to appreciate the effect the FATCA requirements will have, it is helpful to first have background information about the American citizens living abroad who will feel the brunt of the impact.

### *B. U.S. Citizens Living Abroad*

The U.S. government does not formally track how many Americans leave the country, regardless of whether they leave temporarily or permanently, because American citizens are not required to register a place of residence.<sup>28</sup> According to the State Department, about 7.2 million Americans are living abroad.<sup>29</sup> However, regardless of the estimates, the consensus is that the number of Americans living abroad has been on an upward trend over time.<sup>30</sup>

Because the United States does not track where its citizens go, it is difficult to discern where in the world American citizens currently reside, but Canada and Mexico appear to have the most American residents, while Germany, France, the United Kingdom, and Israel also have significant American populations.<sup>31</sup> Many of these Americans are English teachers, IT or communications workers, ex-military members who stayed overseas after completing duty, or retirees.<sup>32</sup> These millions of middle-class Americans have the burden of filing and paying their U.S. income taxes.

### *C. Income Tax on U.S. Citizens Living Abroad*

In addition to any tax obligations they may owe to the country in which they reside,<sup>33</sup> American citizens are responsible for reporting all income, wherever earned, to the IRS and are

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27. See Laura Saunders, *Offshore Accounts: No Place to Hide?*, WALL ST. J. ONLINE (Sept. 20, 2013, 6:08 PM), <http://online.wsj.com/news/articles/SB10001424127887324807704579085511331606786> (“[N]ew reporting rules could affect a U.S. citizen who has retired in Mexico, a German-born green-card holder working in the U.S. or even a Hong Kong-born green-card holder studying in the U.K.—as long as each has a non-U.S. financial account.”); see discussion *infra* Part II.C.3 (discussing FATCA and its reporting requirements).

28. Costanzo & von Koppenfels, *supra* note 23.

29. Saunders, *supra* note 4. Some estimates are as low as 2.2 million, although the U.S. Census Bureau says it is a hard, if not impossible, figure to estimate. Costanzo & von Koppenfels, *supra* note 23.

30. See Saunders, *supra* note 4.

31. Costanzo & von Koppenfels, *supra* note 23.

32. See Saunders, *supra* note 4.

33. Sophia Yan, *U.S. Expats Cry Foul over Tax System*, CNN MONEY (Oct. 30, 2013, 10:04 PM), <http://money.cnn.com/2013/10/30/news/us-expat-tax/>.

subject to a tax on all of that income.<sup>34</sup> For example, an American taxpayer living in India could end up owing the IRS income taxes on income earned from an investment in a British company, while also owing Indian income taxes because that investment was made through an Indian investment bank.<sup>35</sup> Taxation of Americans living abroad can be quite complex,<sup>36</sup> so professional guidance may be necessary when filing a tax return.<sup>37</sup> Expert advice is often used to wade through the specific requirements and calculations of the several applicable exclusions and deductions.<sup>38</sup>

1. *Exclusions and Deductions.* Special deductions and exclusions are available to lessen the harshness of taxing American citizens who live overseas on foreign-earned income in addition to U.S.-source income.<sup>39</sup> Some Americans living abroad are able to minimize their “double” tax liability through the Foreign Earned Income Exclusion (FEIE), the Foreign Housing Exclusion/Deduction, and the Foreign Tax Credit.<sup>40</sup> In order to qualify for the FEIE or the Foreign Housing Exclusion/Deduction, the taxpayer must meet either the bona fide residence test<sup>41</sup> or the physical presence test.<sup>42</sup> A bona fide

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34. Bachmann, *supra* note 5; Saunders, *supra* note 4. However, the income of Americans living abroad is subject to certain exemptions and deductions only available to persons living outside of the United States. See discussion *infra* Part II.C.1 (explaining the various exemptions and deductions available to Americans living in foreign countries).

35. *Income from Abroad Is Taxable*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/Income-from-Abroad-is-Taxable> (last updated Sept. 24, 2014); Saunders, *supra* note 4.

36. See discussion *infra* Part IV.B (discussing complexity of taxing Americans abroad on all of their income).

37. The fact that the IRS publishes a lengthy FAQ dedicated to individual international tax matters speaks to the complexity of filing a U.S. tax return while living abroad. See *Frequently Asked Questions (FAQs) About International Individual Tax Matters*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Individuals/International-Taxpayers/Frequently-Asked-Questions-About-International-Individual-Tax-Matters#GeneralFAQ> (last updated Dec. 4, 2014) (answering frequently asked questions about the tax filing process for overseas Americans).

38. See Yan, *supra* note 33 (discussing multiple examples of Americans living abroad who needed professional help in order to properly file their taxes).

39. See 26 U.S.C. § 911 (2012).

40. Glenn W. White, *U.S. Taxation of U.S. Citizens Living in Canada and Canadians Subject to U.S. Taxes*, 16 CAN.-U.S. L.J. 217, 217 (1990); Michelle Dhanda, Note, *International Taxation: A Guide for Academics Abroad*, 32 SUFFOLK TRANSNAT'L L. REV. 701, 705–06 (2009) (explaining the two statutory provisions that aim to limit the double taxation of Americans living and earning income in foreign countries); see also 26 U.S.C. § 911(a)(1)–(2) (“At the election of a qualified individual . . . there shall be excluded from the gross income of such individual, and exempt from taxation . . . for any taxable year . . . the foreign earned income of such individual, and . . . the housing cost amount of such individual.”); *id.* §§ 901, 904.

41. 26 U.S.C. § 911(d)(1)(A).

resident is an American citizen who has established that he lived in the foreign country for an uninterrupted period covering an entire taxable year.<sup>43</sup> The physical presence test requires that a citizen of the United States be present in a foreign country for at least 330 full days over any period of twelve consecutive months.<sup>44</sup>

The FEIE allows for U.S. persons living abroad to earn up to a certain amount of foreign-earned income tax-free.<sup>45</sup> For 2013 tax returns, the amount of foreign-earned income excluded from taxable income was \$97,600 for individuals.<sup>46</sup> Foreign-earned income is “the amount received by such individual from sources within a foreign country or countries that constitute[s] earned income attributable to services performed by such individual.”<sup>47</sup> Taxpayers living abroad that wish to take advantage of the FEIE must fill out an extra form in addition to filing their tax return.<sup>48</sup> This applies even if their gross income is less than the maximum threshold excludable, which effectively wipes out their tax obligations to the IRS for that taxable year.<sup>49</sup>

The Foreign Housing Exclusion/Deduction allows a taxpayer living abroad to deduct from gross income certain housing-related expenses.<sup>50</sup> Housing expenses include all reasonable expenses paid or incurred by the individual for housing the individual and his family in a foreign country.<sup>51</sup> To be excluded, the expenses must be nonextravagant and nonlavish under the circumstances.<sup>52</sup> All expenses attributable to housing, such as utilities, rent, and insurance, count towards the FEIE.<sup>53</sup> Interest payments and property or rental taxes are not deductible under this section.<sup>54</sup> Employer-paid housing expenses are included in

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42. *Id.* § 911(d)(1)(B).

43. *Id.* § 911(d)(1)(A); see JOEL KUNTZ & ROBERT PERONI, U.S. INTERNATIONAL TAX ¶ B1.04[2][b], at B1-65 (2013) (discussing the bona fide residence test thoroughly).

44. 26 U.S.C. § 911(d)(1)(B); see KUNTZ & PERONI, *supra* note 43, ¶ B1.04[2][b], at B1-65.

45. 26 U.S.C. § 911(b); Mark Nestmann, *Tax Obligations and Tax Breaks for U.S. Citizens & Residents Living Abroad*, NESTMANN (Apr. 9, 2013), <http://www.nestmann.com/tax-obligations-and-tax-breaks#UjiTFcYjKss>.

46. 26 U.S.C. § 911(b)(2)(D); Nestmann, *supra* note 45.

47. 26 U.S.C. § 911(b)(1)(A). The FEIE applies to earned income such as wages, salary, self-employment income, and tips, but does not include any passive income such as dividends, interest, and capital gains. *Id.* § 911(b)(1)(B).

48. Nestmann, *supra* note 45.

49. *Id.*

50. *Id.*

51. 26 U.S.C. § 911(c)(3)(A).

52. *Id.*

53. *Id.*

54. *Id.*

income.<sup>55</sup> The maximum housing deduction depends on the cost of living as well as other factors, resulting in a different maximum deduction for each foreign country.<sup>56</sup> Combined, the FEIE and the Foreign Housing Exclusion/Deduction serve to reduce the taxable compensation of many Americans overseas.<sup>57</sup>

The Foreign Tax Credit provides that the income taxes paid or accrued during the taxable year to any foreign country are allowed as a credit against the income tax owed to the United States.<sup>58</sup> However, the amount of the credit taken cannot exceed the amount that would be paid in taxes to the United States on that foreign income.<sup>59</sup> Also, the Foreign Tax Credit cannot be applied to amounts already excluded or deducted under the FEIE or Foreign Housing Exclusion/Deduction.<sup>60</sup> Although Americans abroad have these exclusions and deductions at their disposal to reduce their income tax burden and help them avoid being taxed twice on the same income, the obligations to report income and assets to the IRS are extensive, and have been even before FATCA.

2. *Reporting of Foreign Assets Before FATCA.* All American taxpayers have always been obligated to report any income earned in the course of engaging in financial activity in offshore jurisdictions.<sup>61</sup> Additionally, they are required to report any assets held outside of the United States when their aggregate value is greater than \$10,000.<sup>62</sup> However, many taxpayers did not comply with reporting their income and assets overseas, often because they were not aware of their reporting obligations.<sup>63</sup>

Before FATCA, the IRS used the Qualified Intermediary (QI) Program to require participating foreign financial institutions to report income on, and withhold taxes from, accounts whose

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55. Tina Salandra & Bobby Shethia, *Expatriate American Tax*, N.J. LAW., Oct. 2011, at 33, 35.

56. *Id.*

57. *See id.* (giving an example of how the income exclusion and housing deduction are calculated to come up with taxable compensation).

58. 26 U.S.C. § 901(a)–(b); *see* Nestmann, *supra* note 45 (describing the Foreign Tax Credit as a “dollar-for-dollar credit against your U.S. income tax liability for income taxes paid while living [overseas]”).

59. 26 U.S.C. § 901(a)–(b); *id.* § 904.

60. Nestmann, *supra*, note 45.

61. *Tax Compliance: Offshore Financial Activity Creates Enforcement Issues for the IRS*, GOV'T ACCOUNTABILITY OFF. (Mar. 17, 2009) [hereinafter *Tax Compliance*], available at <http://www.finance.senate.gov/imo/media/doc/031709mbtest1.pdf> (statement of Michael Brostek, Director, Strategic Issues Team).

62. *Id.*

63. *Id.*

holders were U.S. persons.<sup>64</sup> Participation in the program was underwhelming, however, resulting in a minimal substantive impact on tax evasion prevention and widespread abuse.<sup>65</sup>

The weakness of the QI Program was exemplified by the dispute and settlement between the U.S. government and UBS Swiss Bank.<sup>66</sup> The bank chose not to comply with the reporting requirements at all.<sup>67</sup> As a result, Congress and the IRS came up with FATCA to combat the lack of reporting by foreign financial institutions regarding American accounts.<sup>68</sup>

3. *The Foreign Account Tax Compliance Act.* “Quietly enacted” in 2010 as part of a “big messy bill” entitled the Hiring Incentives to Restore Employment (HIRE) Act,<sup>69</sup> FATCA requires individuals to report any financial accounts they hold outside the United States and obligates foreign financial institutions to report information about American clients and accounts to the IRS.<sup>70</sup> FATCA’s supposed simple premise was to force foreign banks to disclose income held by Americans in offshore tax havens<sup>71</sup> in order to “crack down on illegal overseas tax evasion[,] close[] loopholes,” and make it more profitable for companies to create jobs here in the United States.<sup>72</sup>

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64. 26 U.S.C. § 1441; Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529, 532 (2012).

65. *Tax Compliance*, *supra* note 61.

66. *Id.*; see *Swiss Bank Settles U.S. Tax Charges, Mounting U.S. Pressure on Swiss Bank Secrecy*, 103 AM. J. INT’L L. 338, 338 (2009) [hereinafter *Swiss Bank Settles U.S. Tax Charges*] (describing how, in 2000, UBS voluntarily agreed with the IRS to report to the IRS information about its American clients who held U.S. securities in a UBS account, but for years UBS helped American taxpayers open new UBS accounts in other names or sham entities to avoid being identified by the IRS).

67. *Swiss Bank Settles U.S. Tax Charges*, *supra* note 66, at 338.

68. See Niels Jensen, Note, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 VAND. L. REV. 1823, 1844–52 (2010) (discussing the response to the UBS incidents in which Congress took up the issue of offshore tax evasion through unilateral legislative solutions such as FATCA); Jim Zarroli, *Tax Evaders Beware! Money’s Getting Harder to Hide*, NPR (Aug. 8, 2012), <http://www.npr.org/2012/08/08/158441566/tax-evaders-beware-moneys-getting-harder-to-hide>.

69. Robert W. Wood, *What’s FATCA? Global Banking Meets NSA but Reports to IRS*, FORBES (Oct. 31, 2013, 2:48 AM), <http://www.forbes.com/sites/robertwood/2013/10/31/whats-fatca-global-banking-meets-nsa-but-reports-to-irs/>.

70. 26 U.S.C. §§ 1471, 6038D (2012); Ferauge & Swanson, *supra* note 16.

71. See Zarroli, *supra* note 68 (explaining that to get foreign banks to comply with FATCA, the United States will impose a withholding tax on foreign banks that do not disclose the identities of their American customers).

72. See Ferauge & Swanson, *supra* note 16. Congress intended FATCA “to detect, deter and discourage offshore tax abuses through increased transparency, enhanced reporting and strong sanctions” so that the IRS can “obtain information with respect to offshore accounts and investments beneficially owned by US taxpayers.” *The Foreign Account Tax Compliance Act (FATCA)*, DLA PIPER, <http://www.dlapiper.com/files/Uploads/Documents/FATCA-Alert.pdf> (last visited Feb. 4, 2015).

In implementing FATCA, the U.S. government decided that if foreign financial institutions do not cooperate with reporting obligations, then they are assumedly “sheltering money in tax havens.”<sup>73</sup> FATCA requires foreign financial institutions to assist the IRS with identifying U.S. persons who hold foreign accounts and to disclose certain information about such accounts to the IRS.<sup>74</sup> Under FATCA, U.S. withholding agents<sup>75</sup> will withhold a 30% tax on payments to foreign financial institutions that do not reach an agreement with the IRS regarding accounts held by Americans.<sup>76</sup>

Moreover, any U.S. persons who own such foreign accounts, or any other specified financial assets, must fill out the new Form 8938 in addition to filing their tax return if the account or asset is worth more than \$50,000.<sup>77</sup> Most of these accounts are not accounts used for hiding money, but rather are people’s regularly-used, day-to-day accounts.<sup>78</sup> Account holders are subject to a 40% penalty on understatements of income in an undisclosed foreign financial asset.<sup>79</sup> All of these reporting requirements supplement the required Report of Foreign Bank and Financial Accounts (FBAR) to the U.S. Treasury for foreign financial accounts greater than \$10,000.<sup>80</sup> Due to the complexity

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73. Ferauge & Swanson, *supra* note 26.

74. 26 U.S.C. § 1471(c)(1). Information requiring disclosure includes the account holders’ names, tax identification numbers, addresses, as well as the accounts’ balances, receipts, and withdrawals. *Id.*

75. A withholding agent is an individual or entity with “control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding.” *Withholding Agent*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Individuals/International-Taxpayers/Withholding-Agent> (last updated Nov. 14, 2014).

76. 26 U.S.C. § 1471(a); Lisa Smith, *FATCA Information, Details and Advice*, IEXPATS (Mar. ch 29, 2013), <http://www.iexpats.com/fatca/>. Basically, foreign financial institutions have a choice between the 30% withholding tax on any interest, dividend, or other income paid from U.S. sources to a foreign financial institution or entering an agreement with the U.S. Treasury to disclose information regarding American accountholders. Jensen, *supra* note 68, at 1849–50.

77. 26 U.S.C. § 6038D. *See generally* Kevin Packman, *Foreign Account Reporting Using Form 8938—Has the Service Created Compliance Traps?*, J. TAX’N 197 (2012) (discussing FBAR reporting requirements and the Form 8938).

78. *See* Ferauge & Swanson, *supra* note 26 (“These accounts are normal banking, savings and checking accounts and other investment and financial vehicles . . . held in a bank in a community where the person lives to pay bills and mortgages and to save and invest in order to buy a home, fund children’s education and plan for retirement.”).

79. 26 U.S.C. § 6662(j)(3). Understatements of more than 25% of the account balance or asset value are subject to an extended statute of limitations of six years. *Id.* § 6501(e)(1). Not complying with the Form 8938 requirements can be extra costly because the statute of limitations does not start running until the form is filed. Packman, *supra* note 77, at 205.

80. *See Comparison of Form 8938 and FBAR Requirements*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements> (last updated Feb. 2, 2015) (depicting the difference between the Form 8938 and FBAR

of reporting foreign assets and accounts, Americans living abroad have a greater opportunity to inadvertently break the tax rules.<sup>81</sup>

The complex FATCA in force today “bears almost no resemblance to [the] initial goal of ‘commonsense measures’ to simplify the U.S. tax system.”<sup>82</sup> Originally, the proposal was for foreign 1099s<sup>83</sup> on offshore accounts of a “small number of individuals and companies” located in tax havens, but it has developed into a “massive bureaucratic worldwide reporting system.”<sup>84</sup> The extra reporting obligations imposed on account holders and foreign financial institutions have led to criticism of FATCA.<sup>85</sup> Additionally, FATCA’s reach has caused some Americans abroad to consider the drastic step of renouncing their citizenship, called expatriation, in order to escape the extensive filing burdens.

### III. EXPATRIATION AND ITS TAX BURDENS AND BENEFITS

The Expatriation Act of 1868 displaced the doctrine of perpetual alliance, one of the settled principles of English common law, which disallowed an individual from forsaking his sovereign, allowing Americans to renounce their citizenship.<sup>86</sup> An expatriate is “any United States citizen who relinquishes his citizenship” or a former long-term resident of the United States who is no longer a lawful permanent resident.<sup>87</sup> Expatriation occurs only when there is a voluntary surrender or abandonment of citizenship by following the procedures established by statute.<sup>88</sup>

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reporting requirements and clarifying that the Form 8938 filing requirement does not displace the taxpayer’s obligation to meet FBAR requirements).

81. Packman, *supra* note 77, at 197.

82. Ferauge & Swanson, *supra* note 16.

83. The various 1099 forms report information to the IRS regarding different types of taxable income, including contractor income, interest and dividends earned from investments, and withdrawals from a retirement account. William Perez, *Form 1099*, ABOUT.COM, <http://taxes.about.com/od/taxglossary/g/1099.htm> (last visited Feb. 4, 2015).

84. See Ferauge & Swanson, *supra* note 16 (“FATCA demands comprehensive data from all accounts held by millions of ‘U.S. persons’ living in countries that are clearly not tax havens . . . like Canada, France, Sweden, New Zealand, China and Russia.”).

85. Graffy, *supra* note 25; see discussion *infra* Part IV.C.2 (discussing the potential negative impact of FATCA).

86. Jerry R. Dagrella, *Wealthy Americans Planning to Renounce their Citizenship to Save on Taxes Have a New Problem to Consider: This Time Congress Means Business*, 13 *TRANSNAT’L LAW.* 363, 367–68 (2000).

87. 26 U.S.C. § 877A(g)(2) (2012). Note, however, that “expatriate” as commonly used usually refers to anyone living outside their native country. See *BLACK’S LAW DICTIONARY* 658 (9th ed. 2009) (“[A] person who lives permanently in a foreign country.”). Nevertheless, for purposes of this Comment, “expatriate” will refer to the Internal Revenue Code definition.

88. RICHARD STEEL, *STEEL ON IMMIGRATION LAW* § 15:26, at 684 (2014). Even if foreign nationality is acquired by operation of law, it does not necessarily result in the

*A. Expatriates in Numbers and the Harshness of Renouncing*

The increasing number of American citizens living abroad that have dropped their U.S. citizenship over the past few years shows how life for Americans abroad has become more complicated.<sup>89</sup> Recently, record numbers of renunciations have occurred, with 2,999 Americans giving up their citizenship in 2013.<sup>90</sup> The previous yearly high of 1,781 in 2011 was surpassed in the first half of 2013 alone.<sup>91</sup> In 2012, approximately 900 Americans renounced their citizenship.<sup>92</sup> The 2013 number appears even more extreme when comparing it to 2008, when just 235 Americans renounced.<sup>93</sup> It is true that those numbers are just a “drop in the bucket” compared to the 6 or 7 million Americans living abroad who have not renounced their citizenship, but the number of renunciations increased sevenfold from 2008 to 2011.<sup>94</sup>

When the harshness of renouncing one’s citizenship is factored in, the increase in renunciations appears even more significant. Being an ex-American citizen can make it harder to travel to the United States.<sup>95</sup> For example, individuals who suffer from certain communicable diseases, have committed certain crimes in the past, or have been deemed by the Attorney General to have left the United States for reason of tax avoidance may be denied entry into the country.<sup>96</sup> Persons flagged for any of these reasons may be detained trying to board a plane to the United States or arrested if found entering American soil.<sup>97</sup> As a way of punishing expatriates who left the country for tax reasons, the U.S. government will not issue a visa to any such expatriate.<sup>98</sup>

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loss of citizenship because there must have been an intent to surrender American citizenship. *Id.* One can also renounce his or her citizenship by taking an oath or other formal declaration of allegiance to a foreign state (if the surrender of citizenship was intended) or by serving in the armed forces of a foreign state if those forces are hostile towards the United States. *Id.* Committing an act of treason will also result in a loss of citizenship. *Id.*

89. Saunders, *supra* note 4.

90. Wood, *supra* note 9.

91. Saunders, *supra* note 4.

92. *Overtaxed and Over There*, *supra* note 17, at 38.

93. Dylan Griffiths, *Americans Giving Up Passports Jump Sixfold as Tougher Rules Loom*, BUS. WK. (Aug. 9, 2013), <http://www.businessweek.com/news/2013-08-09/americans-giving-up-passports-jump-sixfold-as-tougher-rules-loom>.

94. Bachmann, *supra* note 5.

95. K&L Gates LLP, *supra* note 7.

96. *Id.*

97. *Id.*

98. Dagrella, *supra* note 86, at 381.

Renouncing one's citizenship is an almost-irreversible choice,<sup>99</sup> and those who do may only regain it through the long and tedious process of naturalization under current U.S. immigration laws.<sup>100</sup> Additionally, the exit tax may become even more financially burdensome if Congress succeeds in increasing the rate, as has been discussed in recent years.<sup>101</sup> Despite the permanent and potentially severe consequences that result from expatriation, many Americans abroad have found several reasons why renouncing one's citizenship is a smart choice under the circumstances.<sup>102</sup>

*B. Why Renounce Citizenship?*

The different tax regimes applicable to American citizens and nonresident aliens lead to benefits in expatriation.<sup>103</sup> For tax purposes, a former citizen is classified as a nonresident alien, and their U.S.-source income is taxed accordingly.<sup>104</sup> The tax rate for nonresident aliens is generally less than the tax on American citizens, if they are taxed at all.<sup>105</sup> The most significant difference is that nonresident aliens do not owe any obligation to report or pay taxes on income earned outside the United States.<sup>106</sup> Also, nonresident aliens are not required to pay estate and gift taxes to the IRS.<sup>107</sup> However, if it is found that the person renounced their citizenship solely for tax reasons, they will owe the citizen rates on all U.S.-source income.<sup>108</sup>

In addition to the tax benefits that can be obtained after renouncing citizenship, some Americans living abroad renounce because they do not appreciate how U.S. federal law treats them differently than Americans residing in the United States in several aspects.<sup>109</sup> For example, FATCA reporting requirements

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99. See K&L Gates LLP, *supra* note 7 (describing the decision to renounce citizenship as "drastic" and "irrevocable").

100. See 8 U.S.C. § 1427 (2012) (explaining the requirements for naturalization, such as residence in the United States, minimal absence from the United States, and high moral character).

101. See K&L Gates LLP, *supra* note 7 (describing proposal to increase exit tax to 30%).

102. Dagrella, *supra* note 86, at 370–71.

103. *Id.* at 370.

104. 26 U.S.C. § 877(b) (2012); Dagrella, *supra* note 86, at 370.

105. Dagrella, *supra* note 86, at 370–71.

106. 26 U.S.C. § 877(b); Dagrella, *supra* note 86, at 370–71.

107. 26 U.S.C. §§ 2001, 2501; Dagrella, *supra* note 86, at 371.

108. 26 U.S.C. § 877(a); Dagrella, *supra* note 86, at 377–78.

109. *Taxation of Americans Abroad*, ASS'N AMERICANS RESIDENT OVERSEAS, <http://www.aaro.org/87-position-papers-2011> (last visited Feb. 4, 2015); see also Ferauge & Swanson, *supra* note 16.

have caused some foreign banks to turn away American clients, leaving Americans living abroad with restricted access and limited choice of banks.<sup>110</sup> In contrast, those residing on American soil have complete freedom and full access to a wide variety of banking choices.<sup>111</sup>

Americans living abroad must meet additional IRS reporting requirements.<sup>112</sup> Americans living in the United States get a deduction for contributions to domestic pension funds, while Americans living abroad do not receive a tax deduction for contributions to foreign pension funds.<sup>113</sup> Additionally, penalties are substantially higher for errors or omissions on tax filings for Americans living abroad than the standard penalties for errors or omissions by those living domestically.<sup>114</sup>

Moreover, American citizens living abroad are required to report anything more than 10% ownership in a single foreign company, while Americans living in the United States have complete freedom to enter partnerships without any requirement of reporting ownership.<sup>115</sup> In the end, many Americans abroad are influenced by the potentially lower nonresident alien tax rate,<sup>116</sup> the disparate treatment by the law of Americans living abroad,<sup>117</sup> and the additional reporting requirements placed upon them.<sup>118</sup> Even though these reasons might provide motivation to renounce citizenship, Americans considering leaving the United States should carefully consider the tax burdens of expatriation.<sup>119</sup>

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110. See discussion *supra* Part II.C.3 (discussing FATCA and its reporting obligations).

111. *Taxation of Americans Abroad*, *supra* note 109.

112. *Id.*

113. Generally, foreign pensions or retirement savings plans are not considered “qualified plans” for tax purposes because such foreign plans are usually not structured in conformity with the complex rules for qualification under the Internal Revenue Code. 26 U.S.C. § 401. Consequently, any participant contributions to such a plan would not be deductible, and any employer contributions would be considered taxable income. *The Taxation of Foreign Pension and Annuity Distributions*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/The-Taxation-of-Foreign-Pension-and-Annuity-Distributions> (last updated Jan. 22, 2015). Take Peter Dunn for example, an Anchorage native who lives in Toronto, Canada and renounced his American citizenship in 2011. Bachmann, *supra* note 5. The tipping point for Dunn was when the IRS wanted to tax him on his Canadian Tax-Free Savings Accounts, which are similar to the tax-free Roth-IRAs in the United States. *Id.*

114. *Taxation of Americans Abroad*, *supra* note 109.

115. *Id.*

116. Dagrella, *supra* note 86, at 370–71.

117. *Taxation of Americans Abroad*, *supra* note 109.

118. *Id.*

119. See discussion *infra* Part III (discussing expatriates and their tax burden). Aside from the exit tax, a person simply has to pay \$450 as the standard expatriation fee, which “may increasingly seem like a bargain.” *Overtaxed and Over There*, *supra* note 17, at 41; K&L Gates LLP, *supra* note 7.

*C. The Tax Burdens of Expatriation*

Many people improperly assume that expatriation will allow them to completely avoid U.S. taxes.<sup>120</sup> There still may be a price to pay in the form of an exit tax, even though renouncing one's citizenship will reduce or eliminate a number of income tax responsibilities.<sup>121</sup> Under the HEART Act of 2008, an American citizen who renounces his or her citizenship must pay a tax on the net gain from the "deemed sale" of his or her worldwide assets.<sup>122</sup> In a deemed sale, "[a]ll property of a covered expatriate shall be treated as sold on the day before the expatriation date for its fair market value."<sup>123</sup> However, the exit tax is new as of 2008, and the expatriation process has changed over time, requiring different tax forms over the years.<sup>124</sup> Additionally, potential expatriates must consider all of the nontax issues that come with expatriation.<sup>125</sup>

Just being an expatriate by itself is not enough to subject an individual to the exit tax.<sup>126</sup> An expatriate renouncing citizenship is considered a "covered expatriate" if they either have a net income or net worth above a certain level<sup>127</sup> or have a negative tax history during the preceding five years.<sup>128</sup>

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120. See Scott Andrew Bowman, *Should I Stay or Should I Go? Tax Considerations in U.S. Expatriation*, FLA. B.J., Sept.–Oct. 2012, at 48, 48 (explaining that covered expatriates are subject to a complex tax regime).

121. K&L Gates LLP, *supra* note 7.

122. *Id.*; see also 26 U.S.C. § 877A(a)(1) (2012); *Notice 2009-85: Guidance for Expatriates Under Section 877A*, INTERNAL REVENUE SERVICE (Nov. 9, 2009), [http://www.irs.gov/irb/2009-45\\_IRB/ar10.html](http://www.irs.gov/irb/2009-45_IRB/ar10.html) (detailing information regarding the U.S.C. § 877A mark-to-market regime).

123. 26 U.S.C. § 877A(a)(1)–(2); see *infra* notes 125–27 and accompanying text (defining covered expatriates).

124. *Expatriation Tax*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Individuals/International-Taxpayers/Expatriation-Tax> (last updated June 28, 2014).

125. See Bowman, *supra* note 120, at 48 ("[P]otential expatriates face a host of nontax issues, which often include selecting a new country of citizenship, deciding which family members will expatriate, managing the formal expatriation process, and determining whether the expatriate will (or will be able to) come back to the United States.").

126. *Id.* at 50.

127. K&L Gates LLP, *supra* note 7. The net income or net worth prong is satisfied if the person has either a U.S. income tax liability greater than \$124,000, adjusted for inflation, for the year prior to expatriation or a net worth of \$2 million or greater. 26 U.S.C. § 877(a)(2).

128. K&L Gates LLP, *supra* note 7. The taxation history prong is satisfied if the person has failed to comply with his or her federal tax obligations, including reporting requirements, during the preceding five years, regardless of whether he or she had taxes due or not in those years. 26 U.S.C. § 877(a)(2). "Even if the expatriate does not otherwise qualify as a covered expatriate under the tax liability test or the net worth test, to avoid being treated as a covered expatriate, an expatriate must satisfy the tax certification test." Bowman, *supra* note 120, at 49. This means that expatriation is a bad way to clear up tax problems from one's past. Saunders, *supra* note 4.

There are exceptions to the exit tax, however.<sup>129</sup> The exit tax does not apply to certain dual citizens who became American citizens at birth.<sup>130</sup> However, they must also be a citizen of another country, continue to be a citizen of that other country,<sup>131</sup> and have no substantial contacts with the United States.<sup>132</sup> The exit tax also does not apply to certain minors.<sup>133</sup>

Despite the strictness of the exit tax rules, some wiggle room remains through smart tax planning to reduce the harshness of the exit tax.<sup>134</sup> However, the different tax moves the taxpayer could make are complex and beyond the scope of this Comment.<sup>135</sup> Nevertheless, the various reasons for renouncing citizenship, and the benefits and burdens of doing so, provide the backdrop for the many arguments against the harmful and burdensome FATCA legislation.<sup>136</sup> As discussed below, the arguments against taxing American citizens living abroad on all of their income, combined with the implementation of FATCA, unnecessarily complicate the lives of those Americans and correspond with the reasons why one would expatriate.

#### IV. ARGUMENTS FOR AND AGAINST IMPLEMENTING FATCA

Some members of the media and Congress stereotype Americans living outside the United States as tax cheats, tax

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129. 26 U.S.C. § 877(c); see Bowman, *supra* note 120, at 51 (“There are two important exceptions from the exit base for ‘eligible compensation items’ and for certain ‘tax deferred accounts.’”).

130. 26 U.S.C. § 877(c)(2)(A)(i).

131. *Id.*

132. *Id.* § 877(c)(2)(A)(ii). An individual has no substantial contacts with the United States only if the individual has never been a resident of the United States as defined in 26 U.S.C. § 7701(b), has never held an American passport, and was not present in the country for more than thirty days during any calendar year during the ten years preceding the loss of citizenship. *Id.* § 877(c)(2)(B).

133. The exit tax will not apply if the following criteria are met: the individual became a citizen upon birth; neither of the individual’s parents was an American citizen at the time of birth; the loss of citizenship occurred before the individual turned eighteen and a half, and the individual was not present in the United States for more than thirty days during any calendar year during the ten years preceding the loss of citizenship. *Id.* § 877(c)(3).

134. Saunders, *supra* note 4. Avoiding the exit tax or reducing the exit tax liability “can be achieved through gifting, thereby reducing net worth for the net worth test, or by postponing gain recognition for several years, thereby reducing income tax liability for the tax liability test.” Bowman, *supra* note 120, at 52.

135. See Saunders, *supra* note 4 (“[A] wealthy person who plans to expatriate might be able to use the U.S. gift-tax exemption of \$5.25 million per individual to shift assets into a trust in order to reduce total assets enough to avoid the exit tax. . . . [A] non-U.S. person could hold assets and make taxfree gifts [from the trust] to other family members who are U.S. citizens or green-card holders.”).

136. See discussion *infra* Part IV.C (discussing the arguments for and against FATCA).

evaders, or even traitors, although that is far from a true description of most Americans living abroad.<sup>137</sup> Instead, such Americans are generally honest and hard-working residents making contributions to the communities in other countries that they call home.<sup>138</sup> Often, American citizens abroad are also citizens of the country in which they reside.<sup>139</sup> Additionally, many of these Americans are unaware that the FATCA requirements exist, yet they face potentially harsh punishment if they fail to comply.<sup>140</sup> The foundation of the argument against FATCA is found in the general arguments against taxing the foreign-earned income of Americans living abroad.<sup>141</sup> Naturally, however, there are solid arguments in favor of the current system of taxing all Americans on all of their income, wherever it is earned.<sup>142</sup>

A. *Arguments for Taxing Americans Abroad on All Income*

The simplest argument for taxing Americans that live in other countries is based on the belief that taxation is simply a cost of being a citizen.<sup>143</sup> Additionally, the benefits theory provides that “individuals continue to enjoy the benefits of citizenship while abroad and, accordingly, should continue to bear the corresponding burdens” such as paying taxes.<sup>144</sup> Some of the benefits provided by the U.S. government to American citizens living abroad can include protection of personal and property rights, the right to vote, the ability to enter the United States at any time, and past benefits received.<sup>145</sup> Under the benefits theory, it follows that these benefits “provide a basis for concluding that the United States is justified in exercising some type of taxing jurisdiction over those citizens.”<sup>146</sup> Additionally, the ability-to-pay theory supports the imposition of the income tax on citizens living abroad by claiming that any citizen

137. Ferauge & Swanson, *supra* note 26.

138. *Id.*

139. *Id.*

140. *See* Graffy, *supra* note 25 (“Many, if not most, [Americans living abroad] don’t know about these requirements. Yet they face fines, penalties and interest for not complying—even if they owe no U.S. taxes, own no U.S. property, have no U.S. bank account and haven’t lived there in years—if ever.”).

141. *See* discussion *infra* Part IV.B.

142. *See* discussion *infra* Part IV.A.

143. *See* Ferauge & Swanson, *supra* note 16 (“In May of 2009, when President Barack Obama unveiled his [FATCA] proposal, he said, ‘Taxation is a price of citizenship.’”).

144. Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. REV. 443, 470 (2007); *see* Cook v. Tait, 265 U.S. 47, 56 (1924) (relying on the benefits theory to justify Congress’s right and power to tax the foreign-earned income of Americans living abroad).

145. Kirsch, *supra* note 144, at 471–77.

146. *Id.* at 479.

who can afford it should pay for the expenses of the common community.<sup>147</sup>

Despite these arguments in favor of the current citizenship-based taxation relying on the benefits the citizens receive and their ability to pay, powerful arguments against such taxation can be made based on the issues of compliance and administrability of the citizenship-based taxation.<sup>148</sup>

### *B. Arguments Against Taxing Americans Abroad on All Income*

The United States is the only industrialized nation to tax its overseas citizens on all of their income, wherever earned.<sup>149</sup> There are various reasons why a federal government would choose not to tax the foreign-earned income of its citizens, such as making life easier for its citizens, economics, equity and fairness, and reducing complexity in filing taxes.<sup>150</sup>

The U.S. government should not make it harder for Americans who choose to live abroad when such action encourages them to renounce their citizenship.<sup>151</sup> Today's economy is global, and many people feel that the U.S. government needs to embrace that fact, not act in ways that hinder America's position in the global economy.<sup>152</sup> Americans living overseas have the potential to be a positive for the U.S. economy.<sup>153</sup> Export markets overseas are very important, and the flow of American goods and services globally is stimulated by the presence of Americans in foreign countries.<sup>154</sup> It can be argued that "[e]nacting fair tax policies that place American employees overseas on an equal footing with foreign counterparts is critical to

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147. *Id.*

148. Cynthia Blum & Paula N. Singer, *A Coherent Policy Proposal for U.S. Residence-Based Taxation of Individuals*, 41 VAND. J. TRANSNAT'L L. 705, 710–11 (2008).

149. See Graffy, *supra* note 25 (mentioning that the United States is the only developed country in the world to tax its citizens on their worldwide income, but Eritrea, a developing country, also taxes its citizens on their worldwide income).

150. See *id.*

151. *Taxation of Americans Abroad*, *supra* note 109.

152. See, e.g., Peter D. Sutherland, *Why We Should Embrace Globalization*, FIN. & DEV., Sept. 2002, at 20, available at <http://www.imf.org/external/pubs/ft/fandd/2002/09/sutherla.htm> (putting forth reasons why the United States should embrace globalization); see also Richard Florida, *Why Americans Seek Opportunity Abroad*, N.Y. TIMES (July 22, 2013, 12:55 PM), <http://www.nytimes.com/roomfordebate/2012/01/08/is-the-us-still-a-land-of-opportunity/why-americans-seek-opportunity-abroad> ("This country should do all it can to embrace the new realities of a highly mobile, ever-circulating global economy—by making it easy for Americans to go overseas . . .").

153. See Florida, *supra* note 152 (arguing that having Americans working overseas will help the U.S. economy by aiding in reestablishing the American middle class).

154. *Taxation of Americans Abroad*, *supra* note 109 ("Export markets overseas are critical to the ability of a U.S. business to employ more individuals back home.").

building a formula for positive domestic economic growth.”<sup>155</sup> It is not ideal for the U.S. populace for American-based companies to choose to employ foreigners overseas rather than send Americans overseas to do the same job.<sup>156</sup>

In addition to the economic reasons for not taxing Americans abroad on their foreign-earned income, there are several arguments based on equity and fairness. Some citizens have no ties to the United States, but were born in U.S. territory or born to American parents.<sup>157</sup> The IRS will still prosecute such citizens for not filing a tax return,<sup>158</sup> even though some feel that these citizens do not receive many benefits from the U.S. government aside from having a U.S. passport.<sup>159</sup>

For example, assume John Doe was born in the United States to foreign parents living in the country on work visas. When John was only six months old, his family moved back to their home country. Thirty years later, even though John never visited or lived in any U.S. territory, he may still be expected to file a tax return each year,<sup>160</sup> which can be quite expensive and inconvenient.<sup>161</sup>

Americans living abroad also receive different treatment regarding Social Security and Medicare taxes.<sup>162</sup> For an individual

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155. *Id.*

156. To clarify, it is ideal for the American workforce in general to keep these jobs in the hands of Americans rather than foreign workers, while many multinational companies have much to gain by establishing business in other countries. *Taxation of Americans Abroad*, *supra* note 109; *see also* Rick Newman, *Why U.S. Companies Aren't So American Anymore*, U.S. NEWS (June 30, 2011), <http://money.usnews.com/money/blogs/flowchart/2011/06/30/why-us-companies-arent-so-american-anymore> (listing several large U.S. companies that have expanded their number of employees overseas and seen significant increases in the portion of their revenues come from overseas business).

157. *See supra* notes 22–25 and accompanying text (discussing *jus solis* and *jus sanguinis* components of U.S. citizenship law).

158. Saunders, *supra* note 4. American citizens must file a tax return and meet reporting requirements even if they do not owe any taxes. *Publication 501*, INTERNAL REVENUE SERVICE (2014), <http://irs.gov/publications/p501/ar02.html>.

159. *See supra* notes 142–45 and accompanying text (discussing the benefits Americans living abroad receive from the U.S. government). For example, look at American citizen Winship Herr, who works as a professor in Switzerland. Margaret Collins & Richard Rubin, *Americans Paying up Wherever They Reside Beseech Congress*, BLOOMBERG (Apr. 24, 2013), <http://www.bloomberg.com/news/2013-04-24/americans-paying-up-wherever-they-reside-beseech-congress.html>. He paid around \$30,000 in U.S. taxes for 2012 even though he received no compensation from any U.S. company nor did he own property in the United States. *Id.* That tax bill was on top of the taxes he paid to the Swiss government. *Id.* To make matters worse, Herr had to pay an accountant \$3,000 to help fill out his U.S. tax paperwork correctly. *Id.*

160. *See* 26 U.S.C. § 911 (2012).

161. *See infra* notes 164–69 and accompanying text (discussing complexity in filing tax returns for Americans living abroad).

162. *Social Security Tax Consequences of Working Abroad*, INTERNAL REVENUE SERVICE (Jan. 19, 2015), <http://www.irs.gov/Individuals/International-Taxpayers/Social-Security-Tax-Consequences-of-Working-Abroad>. *See generally* Michael P. Lewis, Note,

working overseas, even “minor changes in the structure of the business arrangement can result in drastic changes in the rate of [Social Security and Medicare] tax paid by the individual.”<sup>163</sup>

Opting not to tax American citizens living abroad on their foreign-earned income would reduce the complexity such citizens would face in filing their tax returns.<sup>164</sup> Complying with the U.S. tax code is exponentially more complex for those living overseas.<sup>165</sup> In addition to the administrative burden placed on American taxpayers living overseas, the complexity of international tax law “creates an environment where taxpayers who are trying their best to comply simply cannot.”<sup>166</sup>

The complexity of the tax code for filers residing abroad forces them to consult specialized experts to prepare their taxes.<sup>167</sup> Retaining an expert or tax consultant costs around \$2,000 per filing, but can run much higher.<sup>168</sup> With an average of 1 million tax filers annually, the total cost of compliance for overseas Americans comes to around \$2 billion, which is “a high number in proportion to the tax revenue collected.”<sup>169</sup>

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*Addressing Inequities in the Collection of Social Security Taxes for U.S. Citizens Working Abroad*, 37 SAN DIEGO L. REV. 853 (2000) (exploring the discrepancies in tax liability that result from differences in the facts surrounding the individual’s work environment).

163. *Social Security Tax Consequences of Working Abroad*, *supra* note 162; Lewis, *supra* note 162, at 854. Social Security and Medicare taxes are a complex subject of their own, and therefore, a discussion of those tax systems is beyond the scope of this Comment.

164. *Taxation of Americans Abroad*, *supra* note 109.

165. *See id.*

166. TAXPAYER ADVOCATE SERV., INTRODUCTION TO INTERNATIONAL ISSUES: COMPLIANCE CHALLENGES INCREASE INTERNATIONAL TAXPAYERS’ NEED FOR IRS SERVICES AND MAY UNDERMINE THE EFFECTIVENESS OF IRS ENFORCEMENT INITIATIVES IN THE INTERNATIONAL ARENA 129 (2011); Collins & Rubin, *supra* note 159.

167. *See* Yan, *supra* note 33 (discussing multiple examples of Americans living abroad who needed professional help in order to properly file their taxes). One reason why filing taxes while living and working abroad is so difficult is that companies offer a number of benefits to entice Americans to move overseas, and the IRS considers these benefits as income. *Id.* Companies use benefits such as housing, car allowances, and education stipends for children to supplement the salary paid to their overseas employees. *Id.* These additional forms of compensation, that are standard for Americans transferred overseas, make tax accounting incredibly difficult. *Id.* To assist Americans living overseas in filing their taxes, accounting firms publish lengthy booklets covering numerous topics involved in taxation of Americans abroad. *See, e.g.*, KPMG, U.S. TAXATION OF AMERICANS ABROAD (2013), available at [https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/USTAA\\_2013.pdf](https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/USTAA_2013.pdf) (providing guidance to taxpayers regarding income exclusions, employment-related deductions, nonsalary income, and other tax considerations).

168. *Taxation of Americans Abroad*, *supra* note 109; *see also Foreign Accounts Tax Compliance Act (“FATCA”) F.A.Qs.*, DEMOCRATS ABROAD (Dec. 2014), [https://www.democratsabroad.org/sites/default/files/FATCA%20FAQS%20December%202014\\_0.pdf](https://www.democratsabroad.org/sites/default/files/FATCA%20FAQS%20December%202014_0.pdf). Furthermore, “the IRS has overseas offices only in London, Paris, and Frankfurt,” making it more difficult for Americans to receive tax assistance from the IRS. Blum & Singer, *supra* note 148, at 711–12.

169. *Taxation of Americans Abroad*, *supra* note 109.

Furthermore, how should American taxpayers living in different countries be treated in determining tax brackets or the amount of a deduction or exclusion? Currently, all U.S. citizens living abroad are treated the same, regardless of the high or low cost of living and correlating salaries in that country.<sup>170</sup> There are concerns about the relative value of the dollar and the cost of living, which are drastically different in each country, yet American residents living abroad are subject to the same Foreign Income Exclusion and tax bracket structure as those living in the United States.<sup>171</sup> Although American citizens overseas can claim a \$97,600 exclusion on their taxes owed to the United States, many Americans who work in high cost of living nations (such as France or the United Kingdom) earn salaries well above \$97,600.<sup>172</sup> The differences in costs of living in countries abroad are much more extreme than the difference among the fifty states.<sup>173</sup>

Even without FATCA, the way the United States taxes overseas Americans makes their lives more difficult, frustrates economic goals, and unfairly complicates the filing process. The implementation of FATCA only adds to the inherent unfairness of how the U.S. tax system treats Americans who live in foreign countries.<sup>174</sup>

### C. *Why FATCA Will Do More Harm than Good*

For many years, the IRS did not focus on enforcing laws on accounts and assets held by Americans abroad.<sup>175</sup> But filing requirements have been growing stricter since 2008, and many see FATCA as the “tipping point,” although its full effects remain

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170. See Bachmann, *supra* note 5.

171. *Id.*

172. *Id.* For example, the cost of living in London, England is significantly higher than Taipei, Taiwan. See *Cost of Living Comparison Between London, United Kingdom and Taipei, Taiwan*, EXPATISTAN, <http://www.expatistan.com/cost-of-living/comparison/taipei/london?currency=USD> (last visited Feb. 4, 2015) (calculating the cost of living in London to be 122% higher than in Taipei, including a 190% higher monthly rent and a 218% higher cab trip in London than in Taipei); *Cost of Living in France*, EXPATARRIVALS, <http://www.expatarrivals.com/france/cost-of-living-in-france> (last visited Feb. 4, 2015).

173. *Compare Costs of Living Comparison Between London, United Kingdom and Taipei, Taiwan*, *supra* note 172, with *Costs of Living Data Series Third Quarter 2014*, MISSOURIECONOMY, [http://www.missourieconomy.org/indicators/cost\\_of\\_living/index.stm](http://www.missourieconomy.org/indicators/cost_of_living/index.stm) (last visited Feb. 4, 2015).

174. See discussion *infra* Part IV.C (discussing why FATCA will do more harm than good).

175. See Saunders, *supra* note 27 (“Some people felt free to hide assets abroad in a web of secret accounts, and many U.S. citizens living abroad didn’t bother to file returns with Uncle Sam as long as they paid local taxes.”).

to be seen as it just recently went into effect.<sup>176</sup> Despite increasing the tax revenue,<sup>177</sup> FATCA could potentially alienate other countries, forcing millions of U.S. citizens abroad to “either painfully reconsider their nationality, or face a lifetime of onerous bureaucracy, expense and privacy invasion.”<sup>178</sup>

1. *Benefits the Government Foresees Gaining from FATCA.* Naturally, by passing FATCA the U.S. government foresees gaining certain benefits. The stated purpose of FATCA is to reduce tax evasion through overseas accounts, which would result in increased tax revenue.<sup>179</sup> It is unclear how much revenue FATCA will provide the American government, but President Obama suggested \$210 billion over ten years, while others have estimated only \$8 billion over ten years.<sup>180</sup>

In addition to that revenue, the U.S. government will benefit from increased reporting of foreign assets of all American citizens, whether living domestically or abroad.<sup>181</sup> Mathematically, it is likely that most foreign accounts are held by Americans living domestically, given that there are about 7 million Americans living abroad<sup>182</sup> and about 315 million living domestically.<sup>183</sup> However, while Americans living overseas must deal with foreign banks denying them services in efforts to avoid

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176. See *Overtaxed and Over There*, *supra* note 17, at 38; John Gaver, *As USA Celebrates Independence, Americans Declare Independence from FATCA*, EXAMINER (July 4, 2014), <http://www.examiner.com/article/as-usa-celebrates-independence-americans-declare-independence-from-fatca>.

177. Ferauge & Swanson, *supra* note 16 (stating that expected tax revenue from FATCA ranges from \$8 billion to \$210 billion over the next ten years).

178. Graffy, *supra* note 25.

179. However, this is easier said than done. Press Release, U.S. Dept. of Treasury, Remarks by Acting Assistant Secretary Emily McMahon at the NY State Bar Association Annual Meeting (Jan. 24, 2012), available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1399.aspx>; see *Scratched by the FATCA*, ECONOMIST, Nov. 26, 2011, at 86 (“Catching tax cheats is well and good in theory. Achieving that feat in practice is another matter.”).

180. Ferauge & Swanson, *supra* note 16. These figures are not just coming from taxes on income that Americans living abroad are failing to report, but rather this includes income that Americans living domestically are hiding in foreign banks. See *id.*; Saunders, *supra* note 4.

181. See Saunders, *supra* note 4 (“Despite the campaign against undeclared accounts, U.S. taxpayers filed only 825,000 foreign-account reports last year—meaning that millions of people likely aren’t complying with the law.”).

182. *Id.*

183. See *2010 Census Data*, U.S. CENSUS BUREAU, <http://www.census.gov/2010census/data/> (last visited Jan. 7, 2015) (listing the 2010 population of the United States as 308.7 million); see also *Monthly Population Estimates for the United States: April 1, 2010 to December 1, 2014*, AM. FACTFINDER, <http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk> (last visited Feb. 4, 2015) (giving a January 2014 estimate of 317 million).

FATCA reporting obligations, the day-to-day financial activities of Americans living in the United States are not affected by foreign financial banks dropping their American clients.<sup>184</sup> The far-reaching and negative impact of FATCA will seemingly outweigh the benefits by a wide margin.

2. *The Negative Impact of FATCA.* To put the scope of FATCA into perspective, imagine that a law similar to FATCA were passed by a single state within the United States, such as California.<sup>185</sup> This new law places obligations on all people who were born in California or were residents of California, even though they now live in a different state and have no continuing relations with California.<sup>186</sup>

Suppose further that you were born in California but had lived and worked in New York for twenty-five years with your wife and kids, paid taxes in New York, and had no bank accounts in California.<sup>187</sup> You likely would not be too happy about having to report all of your financial holdings to the state of California.<sup>188</sup> Furthermore, if you were a signatory on your spouse's accounts, then you would have to tell California about those too, even if your spouse had never stepped foot in California before.<sup>189</sup> Your children, who are now working adults in New York, may be considered Californians because one of their parents was born there.<sup>190</sup> As a result, they would have to file their taxes in both California and New York and report any bank accounts they have or that they share with their spouses.<sup>191</sup>

Originally, FATCA was to involve only two parties: the U.S. government and foreign financial institutions.<sup>192</sup> However, new stakeholders arose as the Act was developed, including foreign and regional governments, the compliance industry, and most importantly, American citizens living abroad.<sup>193</sup> By 2011, it became apparent that FATCA had grown to target more than just "a small number of individuals and companies" attempting to hide their assets in overseas accounts.<sup>194</sup> Instead, FATCA's

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184. See discussion *infra* Part IV.C.2 (discussing the negative impact of FATCA).

185. Graffy, *supra* note 25.

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. Ferauge & Swanson, *supra* note 16.

193. *Id.*

194. *Id.*

grasp captured “honest, responsible Americans living and paying taxes in other countries” and the Act started to become problematic for many of those Americans.<sup>195</sup>

In addition to the reporting of foreign financial accounts greater than \$10,000 required under the FBAR,<sup>196</sup> any U.S. person who owns a foreign account or asset must fill out the Form 8938 if the account or asset is worth more than \$50,000.<sup>197</sup> The FBAR reporting equally applies to Americans living abroad and domestically, requiring them to report foreign accounts over \$10,000,<sup>198</sup> but domestic Americans who have such accounts overseas are generally not using them as their day-to-day checking accounts.<sup>199</sup> For Americans living abroad, these accounts are often their primary checking accounts used daily to pay bills and put food on the table, not to hide money from the IRS.<sup>200</sup> Yet the IRS imposes penalties on owners of these accounts if they fail to report or underreport income in the undisclosed asset or account.<sup>201</sup>

One of the most serious problems that American citizens living abroad have with FATCA reporting is that it may block banking access in some situations.<sup>202</sup> Even before going into effect July 1, 2014, FATCA made some foreign banks wary of serving even honest Americans because its design was to catch tax evaders.<sup>203</sup> If a foreign financial institution fails to obtain privacy waivers from its American clients, then it must close their accounts to comply with FATCA.<sup>204</sup> This is a way for the Act to circumvent foreign privacy laws without creating conflicts of law.<sup>205</sup> For example, Swiss banks must obtain a client’s consent before disclosing any banking information,<sup>206</sup> resulting in the

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195. *Id.*

196. *See* Packman, *supra* note 77, at 205 (discussing FBAR reporting requirements).

197. 26 U.S.C. § 6038D (2012); *see also* Packman, *supra* note 77, at 197 (discussing Form 8938 requirements).

198. Packman, *supra* note 77, at 205; Jolly & Knowlton, *supra* note 20.

199. *See* Ferauge & Swanson, *supra* note 26.

200. *Id.*

201. 26 U.S.C. § 6662(j).

202. *Unintended Consequences*, *supra* note 16.

203. *Over Taxed and Over There*, *supra* note 17, at 38. For example, David Kuenzi of Thun Financial Advisors “speaks almost daily with ordinary Americans who are having trouble setting up foreign bank accounts or investments, or who have had existing accounts closed.” *Id.*

204. 26 U.S.C. § 1471(b)(1)(F).

205. *See* Jensen, *supra* note 68, at 1850.

206. *See* Erich I. Peter, *Reasonable Limits of Transparency in Global Taxation: Lessons from the Swiss Experience*, 28 TAX NOTES INT’L 591, 615 (2002) (“Swiss bank customer secrecy prohibits . . . a Swiss bank from disclosing any information that a bank customer entrusts to them.”).

bank having to decide between getting the client's approval and closing American accounts.<sup>207</sup>

In order to avoid FATCA's withholding penalties for noncomplying foreign financial institutions,<sup>208</sup> a number of banks have refused to take on Americans as clients, even before the Act went into effect.<sup>209</sup> In some countries, American citizens have had their legal bank accounts closed simply because they were American.<sup>210</sup> Others have had mortgages cancelled for the same reason.<sup>211</sup> Many banks would rather drop Americans as clients than have to report to the IRS.<sup>212</sup>

As a result, many honest Americans living abroad face the decision of paying taxes they believe are fundamentally unfair,<sup>213</sup> or being dishonest and either hiding their heritage from foreign banks or lying to the IRS.<sup>214</sup> To avoid such a decision, Americans living abroad are choosing to renounce their citizenship at an increasing rate.<sup>215</sup>

FATCA is exceptionally detailed and voluminous, with over 500 pages of new regulations written by the Treasury Department.<sup>216</sup> The fact that the Treasury Department announced multiple delays to the start of FATCA reporting, in order to give foreign banks time to comply with the law, points to the complexity of the Act.<sup>217</sup> Even foreign banks are on record citing FATCA as too complicated, complaining that it will be expensive to install the infrastructure necessary to comply with the reporting requirements.<sup>218</sup> For example, the Japanese

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207. Jensen, *supra* note 68, at 1850–51.

208. See Morse, *supra* note 58, at 536–37 (describing how the withholding tax may require additional international relations resources and may produce “unwanted capital market disruptions,” and that the U.S. government lacks the jurisdiction to monitor whether foreign banks are complying with the agreements).

209. *Unintended Consequences*, *supra* note 16.

210. Ferauge & Swanson, *supra* note 16.

211. *Id.*

212. See Graffy, *supra* note 25 (describing the reporting costs and the risk and consequences of making a mistake as “too onerous,” causing banks to question allowing Americans to bank with them).

213. See discussion *supra* Part IV.B (discussing why taxation of Americans' foreign-earned income while they live abroad is unfair).

214. Graffy, *supra* note 25.

215. *Id.*; see also *supra* notes 89–94 and accompanying text (discussing the increasing rate of expatriation from the United States).

216. Ferauge & Swanson, *supra* note 16.

217. Griffiths, *supra* note 93. FATCA reporting was delayed until July 1, 2014, and there was a “previous one-year delay announced in 2011” after being enacted in 2010. *Id.*

218. Bachmann, *supra* note 5; Griffiths, *supra* note 93. Jackie Bugnon, director of the expatriate advocacy group American Citizens Abroad, argues that local banks are being forced to invest in expensive new infrastructure in order to comply with IRS rules because of FATCA. Bachmann, *supra* note 5. Bugnon further argues that “access to foreign

Bankers Association submitted its opinion on FATCA to the Treasury Department.<sup>219</sup> The statement expressed that if “the implementation of FATCA is not practically feasible for the Japanese financial services industry, it would result in substantial confusion in the industry and could ultimately lead the Japanese financial institutions to withdraw their investment from U.S. financial assets.”<sup>220</sup>

Not only will implementing FATCA be expensive and complex for the U.S. government, but of greater concern, filing tax returns will be much more complicated and costly for those living abroad.<sup>221</sup> In addition to the expense of filing a correct tax return as an American living abroad,<sup>222</sup> incorrect filing can result in “excessively harsh” penalties that are “confiscatory and discriminatory.”<sup>223</sup> Having undeclared assets has led to some facing “stiff U.S. tax bills and crippling fines.”<sup>224</sup> Many Americans abroad end up paying lawyers and accountants thousands of dollars each year to help meet the various reporting and filing requirements.<sup>225</sup> Along with the other ways in which Americans living abroad are treated differently than Americans living domestically,<sup>226</sup> it is fundamentally unfair to make the reporting process significantly more expensive simply because they live somewhere besides the United States.

Complexity aside, no cost-benefit analysis has been done on the implementation of FATCA versus the revenue brought in by the Act.<sup>227</sup> Additionally, as the Treasury Department

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financial institutions is being shut off and Americans abroad are being treated like criminals.” *Id.*

219. *Unintended Consequences*, *supra* note 16.

220. FATCA Comment Letter from Japanese Bankers Association, to Internal Revenue Service (Nov. 1, 2010), available at [http://bsmlegal.com/PDFs/FATCA\\_JapanBankers.pdf](http://bsmlegal.com/PDFs/FATCA_JapanBankers.pdf).

221. Griffiths, *supra* note 93; see also Jolly & Knowlton, *supra* note 20. For example, tax filing for American workers living abroad “can involve more than 100 pages and a multitude of forms, such as those for overseas pensions and foreign tax credits.” Collins & Rubin, *supra* note 159.

222. See notes 167–68 and accompanying text (discussing how the complexity of the tax code for American taxpayers living abroad forces them to spend \$2,000 per year on average for expert assistance in filing their tax return).

223. *Unintended Consequences*, *supra* note 16; see *Overtaxed and Over There*, *supra* note 17, at 41 (“Penalties for non-filing can be up to 50% of the account balance. The IRS may go easy if the mistake was innocent . . . [b]ut sorting out the mess can still take 18 months and cost \$20,000 in legal fees . . .”).

224. Saunders, *supra* note 4.

225. *Id.* “The sheer hassle of dealing with all this is prompting more Americans to renounce their citizenship.” *Overtaxed and Over There*, *supra* note 17, at 38.

226. See discussion *supra* Part IV.B (discussing the arguments against taxation of the foreign-earned income of Americans living abroad).

227. James George Jatras, Op-Ed., *Unauthorized FATCA Intergovernmental Agreements’ Are Part of Obama’s Executive Overreach*, FORBES (July 28, 2014),

negotiates intergovernmental agreements (IGAs) with countries all around the world,<sup>228</sup> “changes are fed back into the regulations, making this a nightmare for foreign financial institutions trying to finish compliance projects.”<sup>229</sup> President Obama envisioned needing 800 more IRS agents to run and maintain the system, but that was for the version of FATCA contemplated in 2009.<sup>230</sup> Now that the FATCA system is much greater in magnitude and complexity, the number of extra IRS agents needed has likely increased.<sup>231</sup> The number of IRS agents employed under FATCA will certainly continue to increase if the United States must gather and provide information to foreign governments about accounts held in American banks by foreigners under reciprocity agreements.<sup>232</sup>

Requiring banks and foreign financial institutions to report to the IRS various information about American accounts gives individuals who own those accounts reason to be concerned about their privacy.<sup>233</sup> Some of the information banks are forced to submit potentially includes total assets, account balances, transactions, account numbers, and other personal identifying information.<sup>234</sup> Such an “intrusion goes way beyond a 1099 and [surely] would not be accepted or tolerated by Americans living in [the] United States.”<sup>235</sup>

Another problem presented by the withholding tax approach to curb tax evasion is the possible infringement upon other countries’ sovereignty.<sup>236</sup> Such infringement would come from imposing the withholding tax system on countries with significantly different tax systems and government philosophies than the United States.<sup>237</sup> A country and its financial entities

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<http://www.forbes.com/sites/realspin/2014/07/28/unauthorized-fatca-intergovernmental-agreements-are-part-of-obamas-executive-overreach/>; see also PAUL ROSE & CHRISTOPHER J. WALKER, CTR. FOR CAPITAL MKTS., THE IMPORTANCE OF COST-BENEFIT ANALYSIS IN FINANCIAL REGULATION 11–16 (2013), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf> (discussing cost-benefit analysis and why it should be used).

228. See *infra* notes 258–67 and accompanying text (discussing reciprocity agreements and the problems associated with them).

229. Ferauge & Swanson, *supra* note 16.

230. *Id.*; see *supra* notes 192–95 and accompanying text (discussing how FATCA expanded from what it was originally contemplated to be).

231. See Ferauge & Swanson, *supra* note 16.

232. *Id.*; see *infra* notes 258–67 and accompanying text (discussing reciprocity agreements and the problems associated with them).

233. See Ferauge & Swanson, *supra* note 26.

234. *Id.*

235. *Id.*

236. Jensen, *supra* note 68, at 1839.

237. *Id.*

should have no obligation, absent an agreement otherwise, “to aid other nations in [the] enforcement and administration of their respective tax laws.”<sup>238</sup> “Every country should be free to impose and collect its taxes in the way it deems proper.”<sup>239</sup>

For example, a group of Canadian citizens has sued the Canadian government, challenging its FATCA agreement with the United States.<sup>240</sup> The plaintiffs are angered that the deal requires Canadian financial institutions to give the IRS private information regarding the bank accounts of Americans and their family members living in Canada, regardless of whether those family members are American or Canadian nationals.<sup>241</sup> The claim is that the agreement violates Canadian law, and more specifically, hinders Canadians’ “right to life, liberty, security of the person; security against unreasonable search and seizure; [and] equal protection of law without discrimination.”<sup>242</sup> Additionally, the plaintiffs argue that the agreement goes against the “principle that Canada will not forfeit its sovereignty to a foreign state.”<sup>243</sup> Furthermore, some Canadians have expressed disappointment that their government did not resist the United States’ demands to enter the agreement.<sup>244</sup>

As a result, more foreign banks and financial institutions may choose to drop American clients or not invest in the United States at all, which can both harm the American economy.<sup>245</sup> Many foreign banks and their clients may decide to liquidate all of their investments in the United States because the penalty for banks not complying with FATCA reporting requirements is a 30% withholding tax on investment income originating in the United States.<sup>246</sup> If foreign banks and financial institutions drop American clients, U.S. businesses that establish foreign bank accounts for exports would be majorly handicapped.<sup>247</sup> It also cuts off American businessmen from entrepreneurial opportunities with foreigners if

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238. *Id.* at 1839–40.

239. *Id.* at 1839.

240. Robert W. Wood, *Canadians File Suit to Block FATCA and Prohibit Handover of U.S. Names to IRS*, FORBES (Sept. 12, 2014, 2:12 AM), <http://www.forbes.com/sites/robertwood/2014/08/12/canadians-file-suit-to-block-fatca-and-prohibit-handover-of-u-s-names/>.

241. *Id.*

242. *Id.*

243. *Id.*

244. *Id.*

245. See Saunders, *supra* note 4. Foreign banks may pull their investments in the United States to avoid the 30% penalty on their U.S.-sourced income for failing to comply with the IRS’s reporting demands. *Unintended Consequences*, *supra* note 16.

246. *Unintended Consequences*, *supra* note 16.

247. *Id.*

they have a harder time establishing bank accounts in certain countries.<sup>248</sup>

More importantly, if foreign banks concerned about FATCA reporting drop American clients, Americans living abroad will find it increasingly difficult to attend to routine financial matters such as obtaining mortgage loans or opening checking accounts.<sup>249</sup> Americans should be able to live normally while in other countries, and if lack of access to banks prevents them from doing so, they will not be afraid to renounce their U.S. citizenship in order to be able to pay for their home in a foreign country.<sup>250</sup>

Daniel Kuettel, an American citizen living outside of Zurich, Switzerland, is a perfect example.<sup>251</sup> He gave up his citizenship because he feared that he would not be able to get a mortgage there with so many Swiss banks cutting ties with Americans due to the U.S. government's intensifying pursuit of tax evaders.<sup>252</sup> Furthermore, Kuettel did not even meet the threshold for payment of income taxes to the IRS, so his renunciation was not for tax reasons.<sup>253</sup> Rather, he just wanted to live a normal life.<sup>254</sup>

FATCA could potentially have the severe impact of causing both foreign and American companies to avoid hiring American employees when filling positions outside the United States.<sup>255</sup> The result could decrease "competitiveness as many companies avoid U.S. workers because of the added costs they may have to cover."<sup>256</sup> Some non-American companies may be deterred from promoting Americans to executive positions because executives' tax affairs are much more complicated.<sup>257</sup>

Ideally, reciprocal agreements would result in foreign banks doing much of the legwork in causing undeclared assets to surface, which is the current situation in Switzerland.<sup>258</sup> Requiring foreign banks to report information to the IRS may

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248. *Id.*

249. Ferauge & Swanson, *supra* note 26; Saunders, *supra* note 4.

250. Saunders, *supra* note 4.

251. *Id.*

252. *Id.*

253. *Id.*

254. *See id.*

255. Collins & Rubin, *supra* note 159.

256. *Id.*

257. *Overtaxed and Over There*, *supra* note 17, at 41.

258. *See* Laura Saunders, *Swiss Banks Pressure U.S. Clients*, WALL ST. J. ONLINE (Dec. 27, 2013), <http://online.wsj.com/news/articles/SB10001424052702304753504579282511498311376> ("Swiss banks are pressuring current and former U.S. account holders to disclose undeclared assets to the Internal Revenue Service. . . . In some cases, the banks are freezing accounts unless clients can prove they have declared the account to the IRS. . . .").

reinforce some negative stereotypes about the United States being controlling and manipulative.<sup>259</sup> In order to address this, the Treasury Department has negotiated IGAs with many countries that promise reciprocity in exchange for compliance with FATCA.<sup>260</sup> Diplomatic relationships may be strained as other countries resist signing such agreements or sign under coercion.<sup>261</sup>

As of September 2014, more than eighty nations have signed IGAs with the United States.<sup>262</sup> Countries that enter such agreements can obtain tax information regarding their citizens with assets in American financial institutions.<sup>263</sup> However, questions have been raised as to whether the Treasury even has the authority to promise reciprocal financial reporting to other nations.<sup>264</sup>

Reciprocal laws created by foreign governments, whether from agreement with the United States or on their own action, could also contribute to the billions of dollars of foreign investment funds being pulled out of American banks.<sup>265</sup> This could “drive job-creating capital out of [the United States] and harm [American] financial markets.”<sup>266</sup> It seems unlikely that American banks would be willing to take on the expense of reporting information about foreign account holders to other countries’ governments, just as other countries’ banks are not happy about reporting to the IRS.<sup>267</sup>

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259. See Adam Cohen, *How Europe Sees America: Our Survey on Attitudes About U.S. Cultural and Political Influence*, WALL ST. J. ONLINE (June 19, 2009, 11:59 PM), <http://online.wsj.com/news/articles/SB124534162608828017> (showing the results of a survey of Europeans depicting most European countries as having negative opinions about the United States’ political influence on the world); see also Garry Wills, *Bully of the Free World*, 78 FOREIGN AFF. 50, 51–52 (1999) (discussing America’s history of manipulating and bullying other nations).

260. Graffy, *supra* note 25.

261. Ferauge & Swanson, *supra* note 16.

262. See *FATCA Archive*, U.S. DEP’T OF TREASURY, <http://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx> (last updated Jan. 8, 2015) (listing all of the joint FATCA statements between the United States and other jurisdictions).

263. Graffy, *supra* note 25.

264. *Id.* Rep. Bill Posey, a member of the House Financial Services Committee, asserted the Treasury “had exceeded its authority in promising reciprocal financial reporting to foreign nations.” *Id.* If he is correct, the United States could face the international embarrassment of having coaxed nations into signing these IGAs illegally. *Id.* However, a discussion of whether the Treasury has authority to enter such agreements is beyond the scope of this Comment.

265. Ferauge & Swanson, *supra* note 26.

266. *Id.*

267. See Lynnley Browning, *Complying With U.S. Tax Evasion Law is Vexing Foreign Banks*, N.Y. TIMES, Sept. 16, 2013, at B6 (discussing how American banks disagree with the Treasury pledging to other nations that American banks will provide account data to them regarding foreign investors who have accounts in the United States).

Furthermore, FATCA could adversely affect foreign investment in the United States.<sup>268</sup> Foreign investors are very important to the U.S. economy,<sup>269</sup> so “[e]xposing income from invested foreign capital to the looming threat of a thirty percent withholding tax may deter investors and lead to significant capital flight.”<sup>270</sup>

Despite the potential benefits provided by FATCA, such as increasing tax revenue and thwarting tax evaders hiding money in offshore accounts, the negatives caused by the Act are significant.<sup>271</sup> Once intended solely to reach foreign financial institutions, FATCA has grown to encroach on the everyday lives of Americans living abroad.<sup>272</sup> In order to satisfy the Act’s reporting requirements, all Americans living abroad must fill out separate forms<sup>273</sup> regarding accounts and assets not required to be disclosed to the IRS if held in American banks.<sup>274</sup>

FATCA’s complexity is causing headaches for foreign banks and governments preparing to comply with the reporting requirements.<sup>275</sup> Similarly, the complex rules will make compliance time-consuming and costly for taxpayers and their accountants.<sup>276</sup> Furthermore, cost-benefit<sup>277</sup> and privacy concerns provide additional arguments against FATCA.<sup>278</sup> Although FATCA became effective July 1, 2014, it is not too late to make serious changes to the Act, or better yet, repeal the Act.

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268. Jensen, *supra* note 68, at 1851.

269. *Id.*; see also *Statistical Abstract of the United States: 2010*, U.S. CENSUS BUREAU, tbl.1255 (2009), <http://www.census.gov/compendia/statab/2010/tables/10s1255.pdf> (showing the \$2 billion invested in the United States by foreign countries).

270. Jensen, *supra* note 68, at 1851.

271. See discussion *supra* Part IV.C.1 (discussing the potential benefits FATCA could bring); discussion *supra* Part IV.C.2 (discussing FATCA’s potential negative impacts).

272. Ferauge & Swanson, *supra* note 16.

273. See Packman, *supra* note 77, at 198–99 (discussing FBAR reporting requirements and the Form 8938).

274. See *supra* notes 112–14 and accompanying text (discussing the disparate treatment of the federal tax laws as applied to domestic Americans and Americans living abroad).

275. See *supra* notes 218–20 and accompanying text (discussing foreign banks’ complaints about the complexity of FATCA).

276. See *supra* notes 221–25 and accompanying text (discussing the need for Americans living abroad to hire tax professionals to assist them in complying with FATCA’s reporting requirements).

277. See *supra* notes 227–32 and accompanying text (discussing the need for conducting a cost-benefit analysis for FATCA).

278. See *supra* notes 233–35 and accompanying text (discussing privacy concerns provoked by FATCA).

## V. POTENTIAL SOLUTIONS TO THE FATCA PROBLEM

Much of the literature discussing taxation of Americans living abroad calls for the closing of loopholes that allow Americans to better their tax position by leaving the United States or placing their money abroad, or it suggests harsher penalties should be brought upon those that do.<sup>279</sup> Americans living abroad should not have any extra reasons to turn their backs on their country and renounce their citizenship.<sup>280</sup> The U.S. government should not pass legislation that unevenly places burdens on a relatively small group of Americans when the goal is to obtain a benefit for the entire country. With FATCA, Americans living abroad are finding their banking access restricted and their reporting obligations expensive and confusing.<sup>281</sup> Either taxing Americans only on their U.S.-source income or repealing or significantly amending FATCA would be a proper solution to the problems experienced by Americans residing in foreign countries.<sup>282</sup>

Attempting to prevent Americans from renouncing their citizenship by punishing them, increasing their tax burden, publishing their name, or taking away visa privileges does not encourage Americans to stay in the United States.<sup>283</sup> Although the political motivation of the government to chase and punish tax evaders and foreign banks that help them with their transactions is completely reasonable, many Americans living abroad are “outraged that these regulations have impacted honest and hardworking citizens” so drastically.<sup>284</sup>

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279. See, e.g., Kirsch, *supra* note 144, at 529–30 (concluding that “changes in business practices and technology strengthen, rather than weaken, the case for taxing citizens abroad” and calling for an elimination of the Foreign Earned Income Exclusion); Renée Judith Sobel, *United States Taxation of Its Citizens Abroad: Incentive or Equity*, 38 VAND. L. REV. 101, 159 (1985) (stating that special exclusions and deductions for Americans living abroad raise “serious equity questions of regressivity, distortions of market incentives, and windfalls”); Jorge L. Riera, Note, *Agencies for Purposes of Section 911 of the Internal Revenue Code: The Foreign Earned Income Exclusion Survives 2003 Controversial Proposal to Repeal*, 10 ILSA J. INT’L & COMP. L. 161, 174–76 (2003) (discussing an attempt by Congress to eliminate the Foreign Earned Income Exclusion, even though it helps reduce the harsh effect of double taxation).

280. See discussion *supra* Part III.A (discussing the harshness of renouncing); discussion *supra* Part III.B (discussing why people renounce).

281. See discussion *supra* Part IV.C.2 (discussing negative effects of FATCA implementation).

282. See *Unintended Consequences*, *supra* note 16 (discussing potential solutions to the FATCA problem).

283. See discussion *supra* Part III.A (discussing the harshness of renouncing citizenship).

284. Bachmann, *supra* note 5; see also Collins & Rubin, *supra* note 159 (“100 people [] have . . . urg[ed] Congress to change the laws.”).

One way to simplify the tax code and make filing easier for all Americans, and especially those living abroad, is to only tax American citizens on U.S.-source income.<sup>285</sup> Many people are fond of the idea of only being taxed by the country in which they earned the income, rather than being taxed by the foreign country where they earned the income and the country to which they have citizenship.<sup>286</sup> Renouncing one's citizenship allows the taxpayer to only be taxed by the United States at the 30% rate for U.S.-source income, and at 0% on worldwide income.<sup>287</sup> Of course, there are exclusions and deductions available to reduce the double liability for American citizens living abroad,<sup>288</sup> but that is still a significant and unnecessary hassle.<sup>289</sup>

The ultimate goal should be to tax American citizens on only their U.S.-source income, bringing the United States to the same playing field as the rest of the developed world and in line with being part of a truly global economy.<sup>290</sup> One way to slow down the surge of renunciations is to tax Americans living abroad on the same basis as nonresident aliens.<sup>291</sup> Nonresident aliens maintain a tax home in a foreign country and owe taxes only on income they earn in U.S. territory.<sup>292</sup> President Obama and the previous two presidents all made it their goal to simplify and rewrite the tax code, but none of them succeeded.<sup>293</sup> However, the presidents

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285. See generally Blum & Singer, *supra* note 148 (calling for reformation of the U.S. income tax system to a residence-based system in order to achieve a higher rate of compliance, reduce filing complexity for American taxpayers, and enable the IRS to better enforce tax obligations).

286. See *id.* at 711–13 (describing the taxpayers' perspectives on being taxed based on citizenship through the difficulties they have understanding their tax obligations and filing their returns).

287. See 26 U.S.C. § 871 (2012).

288. See discussion *supra* Part II.C.1 (discussing the exclusions and deductions available to overseas Americans filing their tax return).

289. See *supra* notes 221–26 and accompanying text (discussing the complexity involved in filing one's tax return while living abroad).

290. See Graffy, *supra* note 25 (describing the United States as the only developed country in the world to tax its citizens on their worldwide income).

291. Bachmann, *supra* note 5.

292. *Id.*

293. See, e.g., Linda Feldmann, *Scrap the Tax Code? Bush Floats a National Sales Tax*, CHRISTIAN SCI. MONITOR (Aug. 13, 2004), <http://www.csmonitor.com/2004/0813/p03s01-uspo.html> (discussing George W. Bush's plan to simplify the tax code by using a national sales tax); Kevin Hechtkopf, *On Tax Day, Obama Calls for Simplifying Tax Code*, CBS NEWS (Apr. 15, 2009), <http://www.cbsnews.com/news/on-tax-day-obama-calls-for-simplifying-tax-code/> (stating that "Obama called for simplifying the tax code" in a speech on tax day in April 2009); see also Bill Clinton 1996 *On The Issues: Promoting Growth and Opportunity for America's Small Business*, 4PRESIDENT.ORG, <http://www.4president.org/issues/clinton1996/clinton1996smallbusiness.htm> (last visited Feb. 4, 2015) (listing one of Bill Clinton's platforms as simplifying, unifying, and streamlining the tax reporting process).

are not solely to blame as there are many hurdles that Congress would need to overcome in order to make any drastic changes to the tax system.<sup>294</sup> Because it seems so unlikely that the U.S. government would, or could, make such a drastic change to the tax code at this point, the best option is to repeal FATCA or, at a minimum, make significant changes to it.<sup>295</sup>

Outside of no longer taxing Americans who live abroad on their foreign-earned income, repealing FATCA is the ideal solution. Americans would avoid the problem of banking access denial by foreign banks,<sup>296</sup> reporting foreign accounts and assets would be less complex,<sup>297</sup> and privacy concerns would return to pre-FATCA levels.<sup>298</sup>

At a minimum, changes need to be made to FATCA.<sup>299</sup> Congress needs to refocus FATCA's scope to that of its original modest intent, which was to "track down Americans removing their assets from the U.S. in order to illegally evade paying U.S. taxes."<sup>300</sup>

Several potential changes can be made. For instance, the IRS could exclude from FATCA reporting Americans who establish themselves as bona fide residents abroad as defined by the tax code.<sup>301</sup> This would allow American citizens living abroad long-term to avoid the complex FATCA reporting requirements while still maintaining the primary objective of FATCA.<sup>302</sup>

Additionally, changes could be made to the various reporting thresholds under FATCA.<sup>303</sup> The \$50,000 account and asset value threshold for individual reporting could be raised to \$200,000 or more.<sup>304</sup> This would help because FATCA reporting includes not only bank accounts, but also life insurance contracts and pension

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294. See Lydia DePillis, *Six Reasons Why Tax Reform Won't Happen*, WASH. POST WONKBLOG (July 2, 2013), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/07/02/six-reasons-why-tax-reform-wont-happen/> (listing reasons why the tax code will not be overhauled, including loss of revenue, bipartisanship, public opinion, and change in the economic situation since the last major change in the tax code).

295. See *infra* notes 299–307 and accompanying text (discussing potential changes that could be made to FATCA).

296. See *supra* notes 245–50 and accompanying text (discussing foreign banks' denial of American clients due to FATCA).

297. See *supra* notes 221–25 and accompanying text (discussing how FATCA's complex reporting requirements affect taxpayers).

298. See *supra* notes 233–35 and accompanying text (discussing privacy concerns invoked by the implementation of FATCA).

299. Ferage & Swanson, *supra* note 16.

300. *Id.*

301. *Unintended Consequences*, *supra* note 16.

302. See discussion *supra* Part II.C.3 (discussing the purpose of FATCA).

303. *Unintended Consequences*, *supra* note 16.

304. *Id.*

funds.<sup>305</sup> In the alternative, the \$50,000 threshold could be retained if it was no longer a requirement to report life insurance policies and pension funds.<sup>306</sup> Furthermore, rather than have a 10% reporting threshold for ownership in foreign corporations and partnerships by an American person, it could be raised to 30-50%.<sup>307</sup> Regardless of whether any changes are made to FATCA or not, there should be an independent cost-benefit analysis and audit of FATCA's impact on the IRS, Treasury, and U.S. economy.<sup>308</sup>

The reciprocal agreements represent problems of their own.<sup>309</sup> In seeking reciprocal arrangements with foreign governments providing for mutual reporting by financial institutions about account information for accounts held by that country's citizens, the goal should be solely one of preventing tax evasion, and the goal should be the same for both parties.<sup>310</sup> Developing true partnerships with other countries that respect the foreign laws, constitutions, sovereignty, and interest is more beneficial than the U.S. government coercing or strong-arming them into signing an agreement.<sup>311</sup>

Rather than developing agreements to mutually report account information, it may be more beneficial to eliminate some of the factors that facilitate the use of offshore jurisdictions for tax evasion.<sup>312</sup> In agreements with other countries, the U.S. government could provide incentives to make the creation of offshore entities more difficult, because currently it is relatively easy and inexpensive in many countries.<sup>313</sup>

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305. *Id.*

306. *Id.*

307. *Id.*

308. *Id.*

309. *See supra* notes 258–67 and accompanying text (discussing reciprocity agreements).

310. Ferauge & Swanson, *supra* note 16. Several recent articles argue that an ideal solution to offshore tax evasion involves multilateral informational sharing agreements. *See, e.g.,* Itai Grinberg, *The Battle Over Taxing Offshore Accounts*, 60 UCLA L. REV. 304, 382 (2012); Greg Brabec, Note, *The Fight For Transparency: International Pressure to Make Swiss Banking Procedures Less Restrictive*, 21 TEMP. INT'L & COMP. L.J. 231, 258 (2007) (calling for international cooperation through banking laws that curb illegal financial activity); Suzanne Walsh, Note, *Taxation of Cross-Border Interest Flows: The Promises and Failures of the European Union Approach*, 37 GEO. WASH. INT'L L. REV. 251, 268–69 (2005) (discussing the need for “multilateral efforts to facilitate the reporting and exchange of tax information” between countries).

311. Ferauge & Swanson, *supra* note 16; *see* Morse, *supra* note 64, at 542–49 (suggesting ways in which the U.S. government could maximize its enforcement of FATCA).

312. *See Tax Compliance, supra* note 61, at 4–6.

313. *See id.* at 4 (explaining that anyone can establish an exempted company in the Cayman Islands for less than \$600, and that company will not have to file a list of shareholders).

While the benefits FATCA is intended to produce, such as reducing tax evasion by Americans through foreign banks, are noble, such benefits should not come at the expense of making the lives of Americans abroad unfairly more difficult.<sup>314</sup> In order to prevent these Americans from renouncing their citizenship, the United States should either switch to a tax system that taxes American citizens on only their U.S.-source income<sup>315</sup> or, in the alternative, repeal FATCA or significantly amend it to lessen the harsh impact it will have on Americans living abroad.<sup>316</sup>

Several potential amendments are available that would preserve the primary objective of the Act—to reduce and prevent tax evasion.<sup>317</sup> Any number of these changes would make FATCA fairer to Americans living abroad than the Act as it is currently written.

## VI. CONCLUSION

The problems American citizens abroad have with the unfairness of having to file U.S. tax forms for foreign-source income begin with the fact that the United States chooses to base its federal income tax on citizenship rather than residency.<sup>318</sup> Of course, the IRS provides Americans overseas with multiple exclusions and deductions in order to reduce the chances of double taxation.<sup>319</sup> However, that just adds to the complexity and expense involved in filing a correct tax return when an American has foreign assets.<sup>320</sup> This hassle comes before FATCA even enters the equation.<sup>321</sup>

Before FATCA, there were significant arguments against taxing Americans living abroad on all of their income earned,

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314. See Blum & Singer, *supra* note 148, at 718 (“[T]hose citizens living abroad who are compliant . . . are subject to greater tax compliance burdens than citizens living in the United States; moreover, they suffer the additional unfairness that many other overseas citizens are avoiding the complications and expense of satisfying their U.S. tax obligations with impunity.”).

315. See *id.* at 719–38 (calling for the United States to switch from a citizenship-based tax system to one based on residency).

316. See *Unintended Consequences*, *supra* note 16 (outlining potential changes to FATCA).

317. *Id.*

318. See Wood, *supra* note 19 (“The U.S. is the only industrialized country in the world to impose citizenship-based taxation.”).

319. See discussion *supra* Part II.C.1 (explaining the various exclusions and deductions available to Americans residing abroad).

320. See *supra* notes 221–25 and accompanying text (discussing the complexity and expense Americans abroad will incur to meet FATCA reporting obligations).

321. See *supra* notes 164–69 and accompanying text (discussing the complexity involved in reporting foreign-earned income, even without adding the extra FATCA reporting requirements).

regardless of where it was earned.<sup>322</sup> With FATCA reporting, the unfair singling-out of Americans living abroad is magnified. What started as a bill to catch and prevent tax evaders from hiding their assets overseas has turned into a wide-reaching law.<sup>323</sup> While the Act does have the benefit of cracking down on tax evasion,<sup>324</sup> this benefit comes at the price of disrupting many American families' lives overseas.<sup>325</sup> As a result, many Americans have experienced and will experience blocked foreign banking access,<sup>326</sup> increased expenses associated with filing tax returns,<sup>327</sup> and negative economic and job effects globally.<sup>328</sup>

In order to fix these problems for Americans overseas, the easiest solution is to switch to an income tax system based on residency, taxing only people's U.S.-source income.<sup>329</sup> But because that likely will not happen, the course of action that should be taken is to repeal, or at least significantly modify, FATCA as it stands today.<sup>330</sup> Whether that change is exempting bona fide residents of foreign countries from FATCA reporting or increasing account thresholds for reporting, something needs to be done.<sup>331</sup>

Unfortunately, the outlook for potential change looks bleak, as members of Congress do not value individuals' income tax difficulties as much as they do other issues.<sup>332</sup> And not only will FATCA affect Americans living overseas, but the U.S. government is placing American relations with other countries in the global economy in danger.<sup>333</sup> FATCA needs to be repealed or

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322. See discussion *supra* Part IV.B (discussing the arguments against taxing Americans abroad on their foreign-earned income).

323. See *supra* notes 192–95 and accompanying text (explaining how FATCA's breadth grew immensely over the years).

324. See discussion *supra* Part IV.C.1 (discussing the benefits the U.S. government expects to gain from FATCA).

325. See discussion *supra* Part IV.C.2 (discussing the negative impact on Americans living abroad FATCA will have).

326. See *supra* notes 245–50 and accompanying text (discussing how FATCA could result in Americans being denied as clients at foreign banks and financial institutions).

327. See *supra* notes 221–25 and accompanying text.

328. See *supra* notes 255–57 and accompanying text.

329. See Blum & Singer, *supra* note 148, at 719–39 (arguing that the United States should switch to a tax based on residency).

330. See *supra* notes 277–87 and accompanying text.

331. See *supra* notes 291–300 and accompanying text (proposing several potential changes that could be made to improve FATCA).

332. See *Overtaxed and Over There*, *supra* note 17, at 41 (“[P]oliticians are unsympathetic, since voters assume that the complainers are tax-dodging high rollers.”).

333. See Ferauge & Swanson, *supra* note 16 (stating that FATCA could be “one of the riskiest projects” in terms of “global cooperation and respect” if lawmakers fail to fix it quickly).

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changed,<sup>334</sup> or American families will face unfair and significant difficulties attempting to live their everyday lives in foreign countries.<sup>335</sup>

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334. *See id.* (“The [U.S. government] need[s] to refocus on the original modest, laudable intent of FATCA.”).

335. *See* discussion *supra* Part IV.C.2 (discussing FATCA’s negative impact on Americans living abroad).