March 18, 2013

To: Ways and Means Committee, International Tax Reform Working Group
Subject: International taxation of individuals

Dear members of the Ways and Means Committee,

Thank you for providing the general public the opportunity to comment on tax reform.

The unique US policy of taxation based on citizenship, the enormous complexity of US taxation of foreign income, and the draconian penalties associated with requirements to report foreign assets are creating a true nightmare in the lives of the estimated 6.8 million Americans living abroad and many of the 7.7 million recent legal immigrants living in the US. The toxic combination of these policies creates a situation where a very large number of individuals find themselves under the fear of confiscation of half of what they own, not for failing to pay taxes, but for unknowingly not reporting their assets to the US in confusing and repetitive forms. Some individuals are even unable to keep their bank accounts due to the onerous reporting requirements on both themselves and on their banks. The emotional stress and despair experienced by these individuals is so great that many of them see no alternative but to renounce their US citizenship or immigrant status (green card). In fact, the number of people who take such drastic measure has multiplied by a factor of 7.8 since 2009, when the enforcement of such policies began or increased. This appalling situation has also been thoroughly described by the National Taxpayer Advocate in her latest reports to Congress.

The next pages contain an explanation of the various problems, with extensive references, followed by specific suggestions to solve them, including a summary of current and previous law and a detailed list of relevant sections of the Internal Revenue Code and other statutes. At the end, the suggestions are ranked by order of importance. Of course, these are only suggestions and each one may be considered individually, but I urge the Committee not to completely ignore this subject. So far, the discussion on international tax reform has been focused exclusively on corporations, but a reform of the international taxation of individuals is actually more necessary and urgent.

Sincerely,

Heitor David Pinto

**Citizenship-based taxation and related reporting requirements:**
**Problems and suggested solutions**

*Heitor David Pinto*

## Explanation of the problems

The United States is the only country in the world that taxes the foreign income of its citizens who live abroad (besides Eritrea, a country sanctioned for numerous violations of human rights).[1] Until recently, this policy has not received much attention, but with the enforcement of the draconian penalties of the Report of Foreign Bank and Financial Accounts (FBAR) starting in 2009, the controversial Offshore Voluntary Disclosure Program/Initiative (OVDP/OVDI) of 2009 and 2011, and the intrusive provisions of the Foreign Account Tax Compliance Act (FATCA) passed in 2010 and set to start in 2014, it has become almost unbearable for an American to live in another country.[2–11]

The following analogy, written in a comment to a related article at the Washington Times in 2012, summarizes the current absurd situation lived by many US citizens abroad:

> "What if you were born in California but moved to New York early in life. You live and work and pay taxes in New York for 30 years and one day you find out you were supposed to also file and pay taxes to California, because you were born there and never formally renounced your residency! You are a California Tax Evader! Since you didn't report your New York bank account to California authorities, they are going to confiscate your assets! You have been paying full taxes and complying with New York law, but sorry buddy, you were born in California and therefore must report and pay taxes to your birth state until you renounce California residency. Oh, and renouncing will cost you tons of money and California will threaten to never let you set foot across state lines if you do it. Oh, and your adult children are also facing personal bankruptcy; since you were "Californian" your children are also officially "Californian" until they renounce. Your entire family is destroyed and your New York-born wife wants a divorce.
>
> Finally, New York banks decide they will no longer let Californians have bank accounts with them because the reporting requirements for you people are just too expensive. And California banks won't let you have an account with them either (although they still consider you a resident), because you no longer have an address there. You may therefore have no bank account, no retirement plan, no investments, no credit card, no life.
>
> This grotesque illustration is not at all far-fetched. It is exactly what US citizens are facing, if they have for any reason decided to live outside of the US. US citizens who have lived outside of the states for decades, who are citizens of another country, who have paid taxes and abided by all laws, are now being pursued and persecuted in a breath-taking witch hunt."[12]

There are an estimated 6.8 million Americans who live in other countries,[13] a combined population larger than any of 37 US states, DC or any US territory. These Americans live abroad for various reasons: they are married to a foreigner and chose to live in their spouse's country; they decided to retire overseas for more comfort at more affordable costs; they returned to their country of origin to take care of elderly parents; they returned to the land of their ancestors for religious or cultural reasons; they were offered a job or business opportunity in another country; they were born in the US but moved abroad as children with their family; or they simply were born and lived their entire lives abroad, but are US citizens because at least one of their parents is American.

All of these people must file US tax returns including worldwide income and report their foreign assets to the US, every year, even if they do not actually owe any tax.[14–15] In fact, 82% of US taxpayers residing abroad end up not owing any tax to the US, and the rest of them owe little tax, because they can use the usually higher income taxes they already pay to their countries of residence as a credit on their US tax returns.[16] To put things in perspective, the total income tax paid to the US by these taxpayers amounts to an insignificant 0.3% of the federal tax revenue.[17] Still, they must file US income tax returns every year, and the forms required of them are numerous, very complex and costly, as foreign income is treated with special scrutiny by US tax law (for example, IRS forms 1116, 2555, 3520, 5471, 6251, 8621, 8891 and 8938). Similarly, these taxpayers are also subject to US estate and gift taxes on worldwide assets.[14] Tax treaties, which are supposed to prevent double taxation, are of almost no avail to Americans abroad because every US tax treaty includes a "saving clause" which states that the US can still tax its citizens as if the treaty did not exist.[18]

Most overseas Americans do not file tax returns or reports of assets[16, 19] simply because they are unaware of this obligation. After all, they live in another country, earn their income there, and pay taxes there. However, the penalties for noncompliance to the US are enormous, probably unconstitutional (excessive fines clause of the 8th Amendment),[19] and extremely higher than if the same income had been generated from US sources. For example, failure to disclose a foreign bank account in the FBAR may result in a penalty of 50% of the value of the account, per violation, regardless of tax due.[20] Needless to say, this kind of penalty is devastating for those who have all of their financial assets outside the US, in the country where they live. On the other hand, failure to pay tax on interest from a US bank account results in a penalty that is a percentage of the unpaid tax, not of the income, not of the value of the account. The US accounts themselves do not even have to be disclosed anywhere.

Many Americans abroad have recently tried to become compliant with US taxes, upon discovering this obligation. Many have done voluntary disclosures under the OVDP/OVDI, believing that lower penalties would be assessed, as promised by the IRS, only to end up paying higher penalties than they would have paid if they had normally filed their tax returns and paid taxes late. This tactic has been severely criticized by the National Taxpayer Advocate, who is part of the IRS itself.[19] Also, many if not most Americans abroad simply decide not to comply, and remain unknown to the IRS, because of the draconian penalties they would face if they did. This is an example of a penalty that hinders tax compliance, instead of promoting it, and probably results in a lower tax revenue to the IRS than if it did not exist. Many countries impose no civil or criminal penalties at all for voluntary disclosure, only interest on the unpaid tax, as a way to stimulate compliance.[21]

FATCA requires that foreign banks and other financial institutions report to the IRS information about the accounts of US citizens and residents located overseas. This is a case of another US law being imposed outside its territorial jurisdiction, which by itself is controversial. In practice, many foreign banks, including well-known HSBC, Deutsche Bank and Credit Suisse, have found that the costs of complying with FATCA easily exceed any benefit from having US customers, and have been closing accounts and refusing to open new accounts of US citizens and residents.[2–3] The IRS has already delayed multiple times the deadline for implementation of FATCA due to numerous complaints from foreign banks.[22] One provision of FATCA already in place is an additional form to be attached to a tax return disclosing foreign financial assets, a complete and useless repetition of the information already required by the FBAR.[23] FATCA treats Americans with foreign bank accounts as criminals suspects of tax evasion, but US citizens in other countries have these accounts simply because they live there, to perform mundane activities such as receiving their salaries and paying their bills, not to evade taxes.

Another common situation is that foreigners who immigrate to the US late in life retain the bank accounts they already had in their countries of origin, or have their names added to their parents' bank accounts there for convenience. With the increased FBAR enforcement by the IRS, many immigrants are discovering that they failed to properly file the FBAR and are now subject to confiscation of their or their parents' life savings, which were earned before they even thought about coming to the US.[24–25] Not only does this threat deeply damage the image of the US among immigrant communities, it may also discourage new immigration to the US by other foreigners who already own assets.

This scenario has caused a tremendous amount of fear and confusion, and taken a deep emotional toll, and physical damage in the form of stress and lack of sleep, on the lives of many US immigrants and Americans abroad.[5, 24–26] In other words, US citizens abroad are living a nightmare, and immigrants to the US are seeing their American dreams destroyed.

Immigrants can avoid US taxation by abandoning their US residency status, but the only way for US citizens to become free of these impositions is by formally renouncing their US citizenship, a process which many do not wish to take, due to not yet holding another citizenship, still having family members in the US, or bearing emotional ties to the country where they were born and grew up. Moreover, many of those who renounce US citizenship or immigrant status are subject to an expatriation tax.[27] There is also the 1996 Reed Amendment to the Immigration and Nationality Act, which bars entry to the United States by any person who renounced US citizenship to avoid taxes, even though this provision is not actually enforced.[28] By the way, an expatriation or exit tax is traditionally a trait of authoritarian regimes such as communist countries.[29–31] Nevertheless, despite all disadvantages, the number of Americans who renounce US citizenship has been growing exponentially in recent years, from a few hundred in the past to thousands now, every year.[16] The US Consulate in Toronto even organized a session to perform a mass renunciation.[32] US citizenship is now viewed not as a source of pride, but as a heavy burden by Americans abroad, and as a terrible regret by naturalized citizens.[11, 33]

Americans who live abroad do not receive any benefit from the US government, other than the few benefits for which they pay directly, such as a US passport and other consular services. In fact, the Bureau of Consular Affairs is profitable, earning slightly more revenue from fees than its cost of operation.[13, 34] US citizens obviously cannot benefit from the protection or infrastructure provided by the US government when they are physically abroad. US Social Security benefits are only available to those who contributed to it, and reduced for those who already receive similar benefits from another country.[35] Medicare and Medicaid do not pay for health care outside the US.[36–37] Even in the rare cases of US assistance in evacuating US citizens from a troubled country, they are normally sent a bill afterwards to pay for the cost of the evacuation.[38–39] Therefore, there is no theoretical basis to tax nonresident citizens in the same way that those who reside in the US are taxed.

A change from taxation based on citizenship to one based on residence, like the rest of the world, would not have any significant effect on tax revenue, perhaps even a small increase, and would bring various economic advantages to the United States.[40] It would allow an immense relief for millions of Americans, at no cost to the US government, and at the same time relieve the IRS from processing hundreds of thousands of highly complex tax returns and reports of assets. Also, without the burden of double taxation, more representatives of US businesses would be able to move abroad, greatly stimulating exports of US products, reducing the trade deficit and creating thousands of jobs in the US.[41–42]

Again, no other country in the world, besides Eritrea, taxes people based on citizenship, and there is no reason for the United States to continue this anomaly. By the way, Eritrea has an authoritarian government that does not allow freedom of religion, freedom of speech, political parties, has not held any national elections since independence, and is suspect of providing support to terrorist organizations.[43] Still, even such a country imposes a much lower tax rate, currently 2%, on its citizens who live abroad, and a very simple one-page tax return is required of them.[44] In 2011, the United States condemned Eritrea's diaspora tax and approved a United Nations Security Council resolution against it.[45]

## Suggestions for international tax reform of individuals

(Note: All sections mentioned below are sections of the Internal Revenue Code, title 26 of the United States Code, except as otherwise noted.)

1. Classification of individuals for tax purposes

1.1 Definition of residence

***Currently:*** Aliens are classified into residents and nonresidents. Criteria include lawful permanent resident status (green card) and substantial presence test (weighted sum of 183 days in three years). Exceptions include representatives of foreign governments, foreign students and trainees, and involuntary extended stays due to medical conditions. This definition applies to income taxes but not to estate and gift taxes. Citizens are not classified into residents and nonresidents.

***Previously:*** Before 1985, residence of aliens for tax purposes was not defined in the Internal Revenue Code. Treasury regulations considered residence, for income taxes, as presence without a definite intention to stay temporarily, and for estate and gift taxes, as domicile. Since 1985, these regulations apply only to estate and gift taxes.

1.1.1 ***Suggestion:*** Apply the definition of residence using the substantial presence test to any individual, not only aliens, and maintain the exceptions. Remove lawful permanent resident status from criteria to determine residence, but allow nonresident citizens and nonresident lawful permanent residents to elect to be treated as residents for income tax purposes, if they so wish, by filing the regular income tax return for residents.

***Alternative suggestion:*** Remove the definition of residence from the Internal Revenue Code, allowing the Treasury regulations to apply to any individual, not only aliens. Still allow nonresident citizens and nonresident lawful permanent residents to elect to be treated as residents for income tax purposes, if they so wish, by filing the regular income tax return for residents.

***Relevant section:*** 7701(b).

1.1.2 ***Suggestion:*** If the substantial presence test is maintained, simplify it to 183 days in each year.

***Relevant section:*** 7701(b).

1.2 Definition of United States person

***Currently:*** United States person in the Internal Revenue Code includes citizens and residents.

***Previously:*** The definition of United States person in the Internal Revenue Code has always included citizens specifically, since this term was first defined in 1962.
***Suggestion:*** Remove citizens from the definition, keeping only residents, regardless of citizenship.
***Relevant sections:*** 6038A(c)(3), 7701(a)(30)(A).

1.3 Taxation and reporting requirements of classes of individuals
***Currently:*** Citizens and resident aliens are taxed on worldwide income and assets, with certain exemptions, rates, credits and reports. Nonresident aliens are taxed only on income and assets in the United States, with different exemptions, rates, credits and reports.
***Previously:*** When the United States first created an income tax in 1861, resident individuals were taxed on worldwide income, and nonresident citizens were taxed only on income from the United States. Since 1864, nonresident citizens are taxed on worldwide income as well, and since 1866, nonresident aliens are taxed on income from the United States. In the case of estate and gift taxes, when they were created in their current form in 1916 and 1924, respectively, resident individuals were taxed on worldwide assets, and nonresidents only on assets located in the United States. Since 1932 (gifts) and 1934 (estate), nonresident citizens are taxed on worldwide assets as well.

1.3.1 ***Suggestion:*** Apply taxation of worldwide items to residents, and taxation of United States items to nonresidents, regardless of citizenship. The bulk of this suggestion would be accomplished by replacing “citizen or resident” with “resident”, and “nonresident alien” with “nonresident”, wherever these terms appear in the Internal Revenue Code.
***Relevant sections:*** 2(b)(2)(B), 2(b)(3)(A), 2(d), 5(a)(1), 5(a)(3), 22(f), 25A(g)(7), 26(b)(2)(L), 32(c)(1)(D), 32(c)(2)(B)(iii), 33, 36(d)(1), 36A(d)(1)(A)(i), 63(c)(6)(B), 79(d)(3)(B)(iv), 105(h)(3)(B)(v), 125(j)(4)(B)(iv), 153(2), 167(e)(4)(A)(ii), 168(g)(4)(G), 170(p)(5), 176, 222(d)(5), 303(a)(2), 402(e)(2), 403(b)(12)(A), 404A(e)(2)(A), 404A(g)(1)(A), 406(a), 406(a)(2), 407(a)(1), 407(a)(1)(A), 410(b)(3)(C), 414(q)(8), 483(e)(4), 505(b)(2)(E), 545(c), 565(e), 641(b), 667(e), 668(a)(4), 672(f)(1), 679(a)(4)(A), 679(a)(5)(A), 860G(b), 861(a)(3), 861(a)(3)(A), 861(a)(3)(C)(i), 861(a)(3)(C)(ii), 863(c)(2)(B), 864(b)(1), 864(b)(1)(A), 864(b)(1)(B), 864(c)(1)(A), 864(c)(1)(B), 864(c)(4)(B), 864(c)(5)(A), 864(c)(6), 865(g)(1)(A)(i)(I), 865(g)(1)(A)(i)(II), 865(g)(2), 865(g)(3), 871(a)(1), 871(a)(1)(C)(i), 871(a)(1)(C)(ii), 871(a)(2), 871(a)(3), 871(b)(1), 871(c), 871(d)(1), 871(f)(1)(A)(i), 871(f)(1)(B), 871(f)(2)(A), 871(h), 871(k)(2)(B), 871(n)(1), 871(n)(5), 871(n)(6), 871(n)(7), 872(a), 872(b), 872(b)(3), 872(b)(3)(A), 872(b)(3)(B), 872(b)(4), 872(b)(5), 873(a), 874(a), 874(b), 874(c), 875(1), 875(2), 876(a), 879(a), 879(b), 884(e)(4)(A)(i), 884(e)(4)(A)(ii), 887(a), 893(a)(1), 894(b), 897(a)(1), 897(a)(1)(A), 897(a)(2)(A), 897(g), 897(h)(1), 897(h)(4)(A)(ii), 897(h)(5)(B)(i), 897(h)(5)(B)(iii), 897(h)(5)(B)(iv), 897(j), 901(b)(1), 901(b)(2), 901(b)(3), 901(b)(4), 906(a), 906(b)(1)(A), 906(b)(3), 911(d)(1)(A), 911(d)(1)(B), 932(a)(1)(A)(i), 933(2), 934(b)(2), 936(h)(4)(B), 958(b)(1), 988(a)(3)(B)(i), 993(d)(4)(C)(ii), 996(g), 1235(e), 1291(e)(2), 1361(b)(1)(C), 1361(c)(2)(A)(i), 1361(c)(5)(B)(iii), 1361(d)(3)(B), 1402(a)(6), 1402(a)(8), 1402(b), 1402(c)(2)(C), 1411(e)(1), 1441(a), 1441(b), 1441(b)(2)(D), 1441(c)(4), 1441(c)(6), 1441(d), 1441(e), 1444, 1471(c)(2)(B)(ii), 2001(a), 2053(d)(1), 2101(a), 2103, 2104(a), 2104(c), 2105(a), 2105(c), 2105(d)(1), 2106(a), 2106(b), 2208, 2209, 2501(a)(2), 2501(b), 2501(c), 2501(d)(2), 2511(a), 2663(2), 3121(b), 3121(b)(4), 3121(f), 3121(l)(1), 3231(d), 3306(c), 3306(m), 3401(a)(5), 3401(a)(6), 3401(a)(8)(A)(i), 3401(a)(8)(A)(ii), 3401(a)(8)(B), 3401(a)(8)(C), 3401(a)(8)(D), 3401(d)(2), 3402(f)(6), 3402(l)(3)(A)(ii), 3402(q)(2), 3405(e)(1)(B)(iii), 3405(e)(13), 4372(a), 4372(e), 4404(2)(A), 4404(2)(B), 4980B(g)(1)(C), 5000A(d)(1), 6012(a), 6012(a)(5), 6012(c), 6013(a)(1), 6013(g)(1), 6013(g)(2), 6013(g)(3), 6013(g)(4)(B), 6013(h), 6013(h)(1)(A), 6013(h)(1)(B),

6017, 6018(a)(1), 6018(a)(2), 6038D(h)(2), 6039C(d), 6042(b)(2)(A)(ii), 6044(b)(2)(B), 6046(a)(1)(A), 6046(d), 6046(e), 6048(a)(3)(A)(iii), 6049(b)(2)(C)(v), 6049(b)(5)(A), 6072(c), 6091(b)(1)(B)(ii), 6091(b)(1)(B)(iii), 6091(b)(1)(B)(iv), 6096(a), 6103(h)(5), 6231(a)(1)(B)(i), 6401(b)(2), 6428(e)(3)(A), 6654(e)(2)(C), 6654(j), 7408(d), 7456(b), 7701(a)(39). Also, section 5314(a) of title 31.

1.3.2 ***Suggestion:*** For credits and exemptions that depend on the the citizenship or residence of individuals other than the taxpayer, such as their dependents, spouse, and for estate and gift taxes, remove the restrictions based on citizenship or residence, allowing them for every individual. See also suggestion 3.

***Relevant sections:*** 23(d)(3)(C), 23(e), 24(c)(2), 72(w), 101(j)(5)(B), 152(b)(3), 1041(d), 2032A(a)(1)(A), 2056(d), 2056A, 2057(b)(1)(A), 2057(f)(1)(C), 2057(g), 2201(b)(1), 2513(a)(1), 2522(a), 2522(b), 2523(i), 6166(a)(1).

2. Expatriation provisions

2.1 Expatriation tax

***Currently:*** Individuals who expatriate (renounce United States citizenship or terminate long-term lawful permanent residence) and have net worth or average tax liability above certain amounts, with a few exceptions, are considered “covered expatriates” and all their assets are deemed sold, generating tax on unrealized capital gains and on tax-deferred accounts.

***Previously:*** Before 1965, there was no expatriation tax. Starting in 1965 (and applicable to individuals who expatriated between 1965 and 2008), an individual who was deemed to have renounced United States citizenship for the purpose of avoiding taxation was subject to taxes on capital gains, estate and gifts of corporate assets in the 10 years following expatriation (such assets are not normally taxed of nonresident aliens). Starting in 1995 (and applicable to individuals who expatriated between 1995 and 2008), the previous rule applied also to individuals who terminated long-term lawful permanent residence. In addition, individuals who renounced citizenship or terminated residence were automatically deemed to have done so for the purpose of avoiding taxation if they had net worth or average tax liability above certain amounts. Starting in 2004 (and applicable to individuals who expatriated between 2004 and 2008), in addition to the previous rules, such individuals are considered residents for tax purposes, and taxed accordingly, in a year in which that they physically spend more than 30 days in the United States, if that year is one of the 10 years following expatriation. Because of the 10-year period, these rules are set to finally become obsolete in 2018. The current rules apply to individuals who expatriate since 2008.

***Suggestion:*** Repeal the expatriation tax.

***Alternative suggestion:*** In case Congress insists on retaining an expatriation tax for individuals who terminate residence, several conditions are necessary:

2.1.1 The net worth and tax liability thresholds should be indexed for inflation;

2.1.2 Assets that are still subject to capital gains tax if owned by nonresidents, such as real estate located in the United States, should not be subject to the expatriation tax;

2.1.3 Foreign retirement accounts should not be subject to the expatriation tax;

2.1.4 If deferred, payment of the expatriation tax should not be subject to interest;

2.1.5 If the taxpayer elects, the expatiation tax on unrealized capital gains should be redetermined when the gains are realized, replaced with the part of the realized gains proportional to the period of residence, credited with any foreign tax paid on the same gains, and any expatriation tax previously paid in excess of the redetermined tax should be refunded to the taxpayer;

2.1.6 The basis of assets already owned by individuals who become residents should not be lower than their fair market value at the start of residence, not only for the expatriation tax but also for the regular capital gains tax;

2.1.7 There should be no published list of expatriates.

***Relevant sections:*** 2(d), 871(n)(2), 877, 877A, 2107, 2501(a)(2), 2501(a)(3), 2501(a)(5), 2511(b), 6039G, 7701(a)(50).

2.2 Tax on gifts and inheritance from "covered expatriates"

***Currently:*** Gifts and inheritance received by a citizen or resident from a "covered expatriate" are taxed at the highest estate tax rate in effect, currently 40%, with an exemption of $14,000 (in 2013; indexed for inflation).

***Previously:*** This rule was created in 2008, but it has not been implemented yet.

***Suggestion:*** Repeal the tax on gifts and inheritance from "covered expatriates".

***Relevant section:*** 2801.

2.3 "Sailing permit"

***Currently:*** Aliens are required to obtain a "sailing permit" to certify tax compliance every time they leave the United States. This requirement is not enforced. Citizens are not subject to such a requirement.

***Previously:*** This rule was created in 1921.

***Suggestion:*** Repeal the "sailing permit".

***Relevant sections:*** 6851(c), 6851(d).

2.4 Ban on former citizens

***Currently:*** Former citizens who renounced their United States citizenship to avoid taxes are banned from entering the United States.

***Previously:*** This rule was created in 1996, but so far, no visa has ever been denied because of it.

***Suggestion:*** Repeal the ban on former citizens.

***Relevant section:*** Section 1182(a)(10)(E) of title 8.

3. Exemptions on estate and gift taxes

***Currently:*** Citizens and residents are allowed an exemption of $5,250,000 (in 2013; indexed for inflation) on estate and lifetime gifts. Nonresident aliens are allowed an exemption of $60,000 (not indexed for inflation) on estate and lifetime gifts, but this exemption may be increased by a tax treaty. In addition, all individuals are allowed an exemption of $14,000 (in 2013; indexed for inflation) per year on gifts. Moreover, assets passed by any individual to the spouse are totally exempt from estate and gift taxes if the receiving spouse is a citizen. If the receiving spouse is an alien, the assets are not exempt from estate tax (aside from the general exemption), and are exempt from gift tax up to $143,000 (in 2013; indexed for inflation) annually. Some other exemptions on estate and gift taxes are only available to citizens and residents.

***Previously:*** The exemption on estate and gift taxes of citizens and residents has gradually increased from $50,000 in 1916 to $5,250,000 in 2013. However, the exemption on estate and gift taxes of nonresident aliens has remained at $60,000 since 1977. The restriction that the spouse must be a citizen to be exempt from estate and gift taxes was created in 1988.

***Suggestion:*** Allow the same (higher) exemptions for every individual regardless of citizenship or residence. See also suggestion 1.3.2.

***Relevant sections:*** 2032A(a)(1)(A), 2056(d), 2056A, 2057(b)(1)(A), 2057(f)(1)(C), 2057(g), 2102(b)(1), 2102(b)(2), 2102(b)(3)(A), 2201(b)(1), 2505(a), 2513(a)(1), 2522(a), 2522(b), 2523(i), 6018(a)(2), 6166(a)(1).

4. Retaliation against certain countries through higher taxes on their citizens or residents
   ***Currently:*** If the President finds that a country imposes discriminatory taxes on United States citizens, he is allowed to increase taxes on citizens or residents of such country or deny them a foreign tax credit.
   ***Previously:*** These provisions were created in 1934 and 1966.
   ***Suggestion:*** Repeal the retaliation against certain countries through higher taxes on their citizens or residents.
   ***Relevant sections:*** 5(a)(2), 871(n)(3), 871(n)(4), 891, 896, 901(c), 2014(h), 2108.

5. Requirements to report foreign income and assets

   5.1 Passive foreign investment companies
   ***Currently:*** Passive foreign investment companies (foreign mutual funds) held by United States persons are subject to tax on unrealized gains and to a detailed reporting requirement.
   ***Previously:*** This provision was created in 1986.
   ***Suggestion:*** Repeal the special treatment of passive foreign investment companies.
   ***Relevant sections:*** 1291, 1293, 1294, 1295, 1296, 1297, 1298.

   5.2 Foreign Account Tax Compliance Act
   ***Currently:*** Foreign financial institutions are required to find and report accounts of United States persons. Otherwise, the institutions are subject to withholding tax on any payments coming from the United States.
   ***Previously:*** This provision was created in 2010, but it has not been implemented yet.
   ***Suggestion:*** Repeal the reporting requirement of foreign financial institutions and the associated withholding tax.
   ***Relevant sections:*** 1471, 1472, 1473, 1474.

   5.3 Reports of foreign gifts, inheritance and trusts
   ***Currently:*** United States persons are required to report gifts and inheritance above $100,000 received from foreign persons, and foreign trusts. Although these items are not taxed, they are subject to a penalty of up to 25% (gifts and inheritance) or 35% (trusts) if not reported.
   ***Previously:*** The requirement to report foreign gifts and inheritance was created in 1996. The requirement to report foreign trusts was created in 1962.
   ***Suggestion:*** Repeal the requirement to report foreign gifts, inheritance and trusts, and the associated penalties.
   ***Alternative suggestion:*** Apply the penalties to unpaid tax, not to the value of unreported items.
   ***Relevant sections:*** 6039F, 6048, 6677.

   5.4 Reports of foreign corporations and partnerships
   ***Currently:*** United States persons are required to report foreign corporations and partnerships.
   ***Previously:*** These requirements were created in 1938, 1960, 1982, 1984 and 1990.
   ***Suggestion:*** Repeal the requirement to report foreign corporations and partnerships.
   ***Relevant sections:*** 6038, 6038A, 6038B, 6038C, 6046, 6046A.

   5.5 Reports of foreign bank and financial accounts
   ***Currently:*** United States persons are required to report accounts above $10,000 held in foreign

banks directly to the Department of the Treasury. Although the value of the accounts is not taxed, it is subject to a penalty of up to the greater of 50% or $100,000 if not reported. Foreign bank accounts above $50,000 also have to be reported in the income tax return, but the penalties for not reporting them there are a percentage of the possibly unpaid tax on income associated with the accounts, not on the value of the accounts.

***Previously:*** The requirement to report foreign bank accounts directly to the Treasury was created in 1970. Before 2004, the penalty was up to the greater of $25,000 or the value of the account, limited to $100,000. The additional requirement to report foreign bank accounts in the income tax return was created in 2010.

***Suggestion:*** Repeal the requirement to report foreign bank and financial accounts directly to the Treasury, and the associated penalties. The requirement to report them in the income tax return may be maintained if deemed necessary.

***Alternative suggestion:*** Apply the penalties to unpaid tax, not to the value of unreported items.

***Relevant sections:*** Sections 5314 and 5321(a)(5) of title 31 concern the report to the Treasury and its penalties. Sections 6038D, 6662(b)(7) and 6662(j) of title 26 concern the report in the income tax return and its penalties.

## Order of importance of suggestions

Repeal FBAR, or at least its penalties (5.5)
Repeal tax on gifts and inheritance from covered expatriates (2.2)
Repeal ban on former citizens (2.4)
Repeal reports of foreign gifts, inheritance and trusts, or at least their penalties (5.3)
Reclassify individuals according to residence and not citizenship for tax purposes (1.1.1, 1.2, 1.3.1)
Remove restrictions based on citizenship or residence on certain credits and exemptions (1.3.2)
Equalize exemptions on estate and gift taxes for all individuals (3.)
Repeal or modify expatriation tax (2.1)
Repeal FATCA reporting by foreign banks (5.2)
Simplify substantial presence test (1.1.2)
Repeal PFIC regime (5.1)
Repeal retaliatory taxes (4.)
Repeal sailing permit (2.3)
Repeal reports of foreign corporations and partnerships (5.4)

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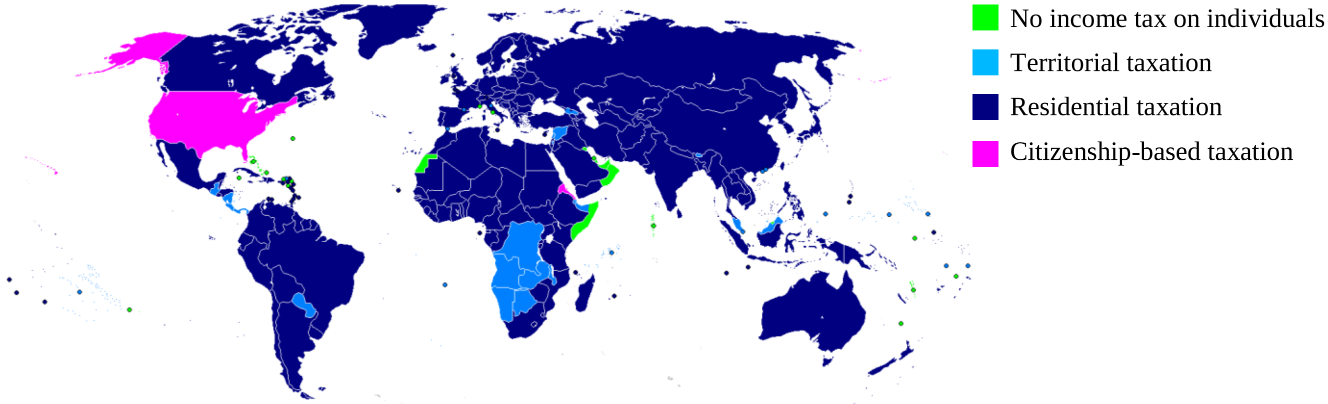


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