

American Citizens Abroad (ACA)
The Voice of Americans Overseas

Mr. Gerald Shields
Internal Revenue Service
Room 6129
1111 Constitution Avenue, N.W.
Washington D.C. 20224

Concerns: Statement of Foreign Financial Assets
OMB No. 1545-2195
Form No: 8938

November 18, 2011

Dear Mr. Shields,

It is an honor for American Citizens Abroad (ACA) to have the opportunity to comment on the September 28, 2011 draft for 2011 Instructions for Form 8938. Our comments will follow the topics specifically listed.

- a) Whether the information is necessary for the agency to perform its duties
- b) The accuracy of the time estimate
- c) Ways to enhance quality and clarity
- d) Ways to minimize burden including electronic means
- e) Estimates of costs to purchase services to provide information

Whether the information is necessary for the agency to perform its duties

ACA strongly believes that the information is not necessary for the agency to perform its duties for essentially two reasons.

First, the Commissioner of the IRS has recently publicized many prosecution cases against many American citizens who had hidden financial resources in foreign bank accounts and against many financial intermediaries who were part of a network facilitating tax evasion for U.S. residents. The IRS and FinCen have announced their intention to continue to mine the data obtained through the UBS case and through the voluntary disclosure programs to pursue additional prosecutions. Such a targeted approach is effective and much more cost efficient than the heavy-administrative broad brush approach required by FATCA legislation, for both American citizens resident abroad and for foreign financial institutions. The IRS already has multiple tools available to track down tax evaders – the QI program, the John Doe summons, Tax Information Exchange Agreements, Mutual Legal Assistance Treaties, the Swift Agreement, the whistleblower program and so on.

Second, Americans who have financial assets overseas are already required to file Form TD F 90-22.1 “Report of Foreign Bank and Financial Accounts (FBAR). Form 8938 creates duplicate filing to two different Treasury Department agency addresses with different criteria and duplicating heavy-handed penalties for civil failures, which is bound to create confusion and new compliance cost burdens. Furthermore, the U.S. imposes taxes on worldwide income, not on assets. Reporting of assets is superfluous. Furthermore, it is extremely difficult to determine the value of certain assets as there are several ways to make estimates, which places a burden of uncertainty and risks of penalties for the tax filer.

Form 8938 certainly increases the risk for the taxpayer of stolen identity as all foreign financial information with account identification will be in the same package with the income tax return, social security number, name and address of the individual. This poses a particular problem for Americans residing abroad who have most of their assets overseas.

A fundamental question should be raised with regard to Form 8938 and, in fact, all elements of FATCA legislation. Do the potential benefits for the U.S. Treasury justify the huge costs of compliance, not only for individual American citizens with financial accounts overseas, which will probably exceed \$500 million a year, but also for the IRS itself? The IRS must already devote significant resources to develop forms and instructions for the taxpayer as well as regulations and software for foreign financial institution reporting. In the future, the IRS will have to process mountains of data that are not directly connected to income tax declarations, data coming not only from American tax filers but also from more than 250,000 foreign financial institutions worldwide. Form 8938 will probably delay the transition to electronic reporting of the 1040 for Americans overseas, another source of inefficiency for the IRS. Given the Joint Committee on Taxation estimate of additional revenues of less than \$ 1 billion a year over ten years and the high compliance cost for FATCA, the benefits for the U.S. Treasury do not justify the cost. And this does not even take into consideration the fact that FACTA imposes compliance costs on foreign financial institutions that are estimated in the tens of billions of dollars over the next two years, at a time when financial institutions are highly vulnerable, in particular in Europe. ACA strongly urges that the Department of the Treasury to inform Congress of this issue and to encourage Congress to repeal FATCA.

The accuracy of the time estimate

The IRS average estimated time to complete Form 8938 is 1 hour and five minutes although the IRS recognizes that the time needed to complete the form will vary according to individual circumstances. ACA's review of the form instructions alone required more than two hours to attempt to understand what is required. In order to complete Part I, tax filer must prepare an Excel worksheet to develop a record that determines the maximum value based on periodic account statements. Depending on the information available concerning other foreign assets to be reported under Part II, such a worksheet may also be required. Part III definitely requires the development of a separate Excel worksheet to bring together all of the revenues from various foreign deposits, custodial accounts and other foreign assets for the presentation requested and to ensure coordination with revenue reported on the 1040 and its annexes. ACA estimates that the average preparation time will be at least three times the IRS time estimate, and that this time is in addition to the time required to fully comprehend the instructions.

Ways to enhance quality and clarity

We submit for your consideration the following comments aiming to clarify:

- 1) Page 2, second column under "Foreign currency exchange rate", you should add to the first sentence so that it reads ".....converted to U.S. dollars **using the year end exchange rate.**" The second sentence should also read ".....U.S. Treasury Department's Financial Management Service foreign currency exchange rate for purchasing U.S. dollars **at year end.**"
- 2) Starting in the third column on page 2 and continuing to the top of column 3 on page 3, you provide examples of "joint interests": it would help the reader if you made two sub-categories for examples - U.S. residents and Bona fide residents in a foreign country – and put the respective examples under these categories. You have made this distinction under "Determining the Reporting Threshold That Applies to You." Consistency and clarity would lead to the same approach under "joint interest".
- 3) On page 3 "Specified Foreign Financial Assets." It is our understanding that ownership of one's home is not included in the definition of "Specified Foreign Financial Assets". Similarly, as you refer to "financial assets", it would seem that direct investment in foreign real property (real estate) is not included in the definition of "Specified Foreign Financial Assets". If you state that direct investment in real estate is not included in the definition of "Specified Foreign Financial Assets", it would avoid a lot of uncertainty for the tax filers. This clarification could be added as a separate section after "Assets held for investment" and entitled "Direct ownership of real property that does not need to be reported" or it could be clarified on page 5 under "Exceptions to Reporting".
- 4) On page 3, the second bullet point under "Foreign financial institution" in the third column is awkward. It would be better if it were reversed in order. "It holds financial assets for the account of others, as a substantial part of its business."
- 5) Page 4, first column, "Interests in assets held by disregarded entities." What is a disregarded entity? This needs explanation.

- 6) Page 4, bottom of first column: "Interests in jointly owned assets." This is just a repeat referring people back to an earlier section. It is wordy and not clear. If you feel it is important to include this reference in this section, perhaps you might just say, "**Interests in jointly owned assets**. Please refer to the various circumstances determining your reporting of joint ownership which are specified on page 2 under "Determining the Total Value of your Specified Foreign Financial Assets".
- 7) Page 4. Third column: "Figuring Maximum Value". Just after the first paragraph and before "Assets with no positive value." you should insert two paragraphs which are now on page 5: "Valuing financial accounts" and "Valuing other specific foreign financial assets". The first question that comes to mind when you mention "maximum value" on page 4 is how to determine it. These two paragraphs answer that question. Then on page 5, you may want to repeat "Valuing other specific foreign financial assets and have the examples follow.
- 8) Page 5, second column, under "Valuing interests in estates, pension plans, and deferred compensation plans", it might clarify to add a sentence at the end. "For pension contracts where you receive annuity payments and have no capital value, the annuity cash payments correspond to the maximum value for the year." It should also be clarified whether retirement benefits received from foreign governments (i.e. similar to U.S. Social Security payments) are to be disclosed (see further discussion below).
- 9) Page 7. Second column, "Part 1. Foreign Deposit and Custodial Accounts". The request is for a separate page for each account. By individual account do you mean each sub-account of a master account? Under one master account number, an individual may have a current account and two or three investment accounts. If you want each sub-account listed, you should clarify.
- 10) Page 7, third column, under **Line 6**, No 3. It would be helpful for the taxpayer if you repeated here the website reference to the U.S. Treasury Financial Management Service.
- 11) The law talks of all financial contracts; the instructions address only foreign financial assets. Presumably, mortgage contracts need not be mentioned as they are a liability, even though they may be viewed as a "financial contract". This should be clarified as many long-term bona fide overseas residents own their homes and have a mortgage on that home. If you intend that taxpayers report the asset value of their homes, it should be clarified that they should report the net asset value – i.e. the estimated market value at year end less the mortgage outstanding.
- 12) Health insurance contracts are also financial contracts. Do they have to be listed somewhere? Hopefully not, and if this is the case, it should be specified that they are not to be reported.
- 13) There is no guidance as to how one would determine the value of a minority interest in a privately held non-investment business that is not excused from filing Form 8938 under the duplicate reporting exemption. Normally value is clear only when such investments are sold. Would providing the cost of the investment be acceptable or would just an estimate based on the profitability of the business be required, and if so how should it be determined, if a valuation is not required, as indicated by the instructions?

Ways to minimize burden including electronic means

By reducing the scope of reporting required and maintaining systematic valuation methods, the reporting burden would be greatly alleviated, in particular for Americans who are bona fide overseas residents.

- 1) Clarify that investments in real estate (real assets) are not included in the term "financial assets" and that mortgage contracts need not be reported. The text on page 4, column 1, is so broad that it could be interpreted to include real estate and a mortgage; "You have an interest in a specified foreign financial asset if any income, gains losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the asset are or would be required to be reported, included, or otherwise reflected on your income tax return. You have an interest in a specific foreign financial asset even if there are no income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the asset included or reflected on your income tax return for this tax year."
- 2) Exclude from the reporting requirement foreign government retirement funds (equivalent of US Social Security). During the period when individuals are working and are contributing to these funds, they have no access to the funds and in many instances will not be able to know the "market value" of the accumulated rights. When people retire, government social security programs often become annual payments with no capital value. If we understand the instructions correctly, it would be necessary to report on Form 8938 the cash value of the annual payments from government retirement plans, the same amount that is reported as income on the 1040; this is superfluous and duplicate reporting. It is furthermore misleading as Form 8938 requires applying year-end exchange rates whereas the taxpayer will apply the average exchange rate to determine the revenue on the 1040. The same foreign currency amount would have two different U.S. dollar values, creating confusion.

- 3) Similarly, exclude private foreign pension funds. During the accumulation period, the individual cannot touch the funds and often does not have access to information to determine a "market value". Upon retirement, individuals may have the choice between taking the accumulated capital in one lump sum, in which case the amount would become reportable as a "financial asset", or converting the capital into an annuity. The actual market value is known only at the time of retirement. If an individual opts for annuity payments, the situation is comparable to government retirement plans with the need to report the annuity amount on Form 8938 as well as on the 1040, which is superfluous and a source of confusion.
- 4) On page 5, it is specified that valuing financial accounts must be based on the maximum value whereas valuing other specified foreign financial assets may use year-end value. It would greatly simplify the reporting for the taxpayer if year-end values are systematically applied to all overseas assets, including those in financial accounts. This makes all the more sense as the instructions require use of year-end foreign exchange rates to determine the value to report in U.S. dollars. Furthermore, by requiring the maximum value in financial accounts, the IRS is going to receive a lot of double or irrelevant reporting, which will be a source of confusion and will lead to unrealistic reporting. The most obvious case is where a person transfers a substantial amount from one account to a second account. Reporting the maximum in both accounts will lead to double reporting. The Treasury is seeking a balance sheet image of American taxpayer assets overseas; this calls for applying the same valuation date for all assets; why should reporting financial assets overseas be different?
- 5) It is our understanding that life insurance policies with cash value must be reported as an "other financial asset" whereas term insurance with no cash value does not have to be reported. This should be specified in the instructions.
- 6) Eliminate reporting for amounts identical to amounts reportable as current year income on Form 1040 (e.g. annual payments from foreign retirement plans). If elimination of such amounts is not considered feasible, substitute the requirement to report such amounts with "yes" or "no" questions and instruct taxpayers to report relevant amounts on Form 1040.

Estimates of costs to purchase services to provide information

Tax preparers working for Americans residing abroad have indicated that preparation fees will have to be increased to accommodate the additional time required. The total cost will depend on the hourly billing rate and the actual time required. The amount may range from \$300 for a simple case to more than \$10,000 for complicated cases. Some practitioners may refuse to complete this form for the taxpayer, given the perceived legal risks for the tax filer of even unintended omissions where the IRS may assert the form was incomplete and should be treated as not filed. This is an onerous, discriminatory reporting cost for Americans resident overseas who by necessity have foreign financial assets and who in most instances do not owe U.S. taxes because they live in higher tax countries than the United States. We urge the IRS to encourage Congress to eliminate Section 6038D. In addition, we strongly urge the IRS to adopt a policy that explicitly permits a reasonable cause exception from penalties for failure to file Form 8938 for assets relating to income that is properly reported on Form 1040.

We hope that the above comments will be useful to you and thank you for the opportunity to be able to express our concerns and suggestions.

Sincerely yours,

Jackie Bugnion
Director

Marylouise Serrato
Executive Director

CC: The Honorable Nina Olson, National Taxpayer Advocate
The Honorable Timothy F. Geithner, Secretary of the Treasury
The Honorable Douglas Shulman, Commissioner of the Internal Revenue Service