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## Taxpayer Uncertainty Prompts Citizenship Renunciations

JANUARY 18, 2012

BY MICHAEL COHN, EDITOR-IN-CHIEF, [ACCOUNTINGTODAY.COM](http://AccountingToday.com)

The Internal Revenue Service's newest version of the Offshore Voluntary Disclosure Program is designed to give some reassurance to taxpayers who have been hesitating to come forward and disclose their foreign bank accounts, but the increasing complexities of U.S. tax law are leading more people to renounce their citizenship.

A newly released [report](#) to Congress from National Taxpayer Advocate Nina Olson shows that the IRS's approach to tax compliance by those with foreign bank accounts is still leading to confusion among taxpayers. More and more taxpayers living abroad are going so far as to renounce their U.S. citizenship to avoid dealing with all the headaches.

"Many U.S. taxpayers abroad are confused by the complex legal and reporting requirements they face and are overwhelmed by the prospect of having to comply with them," said the report. "Some are even renouncing their U.S. citizenship for that reason; about 4,000 people did so in fiscal years 2005 to 2010. Renunciations increased more than tenfold from 146 in FY 2008 to 1,534 in FY 2010, with 1,024 renunciations in the first two quarters of FY 2011 alone."

The report also found fault with the "bait and switch" approach taken by the IRS enforcement staff with some taxpayers who had come forward under the older voluntary disclosure programs with the promise of reduced penalties, only to find themselves subjected to steeper penalties.

"While the maximum penalty for a 'willful' failure to report foreign accounts on Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR) is severe, people who voluntarily correct inadvertent violations are generally not subject to a significant penalty," said the report. "Nonetheless, the IRS 'strongly encouraged' nearly everyone with a violation to participate in the 2009 Offshore Voluntary Disclosure Program (OVDP) or face potentially excessive civil and criminal penalties. More than a year after the 2009 OVDP ended, the IRS changed key terms of the program to the detriment of those with inadvertent violations, damaging the IRS's credibility. The IRS's statements also leave the public confused and concerned that excessive FBAR penalties may apply to inadvertent violations."

She noted that while the IRS's longstanding policy is to use penalties "to encourage voluntary compliance," the agency may have used penalties as leverage against taxpayers who have entered into voluntary disclosure programs, often penalizing those who are trying to become compliant. Many taxpayers appear to believe the IRS will always seek to apply the maximum penalties, regardless of the situation, even to "benign actors."

"Absent clear procedures and transparent guidance about how these benign actors can return into compliance without being subject to maximum penalties, the IRS is squandering an opportunity to substantially improve voluntary compliance by millions of low profile U.S. taxpayers abroad," said the report.

Bob McKenzie, a tax partner at the Chicago law firm Arnstein & Lehr, has been trying to help his clients cope with the IRS's voluntary disclosure programs. Despite some improvements, he still sees some problems with the latest version, particularly the lack of a deadline.

"Most of my clients are in the two prior iterations," he said. "We saw that most of the activity was in the last few weeks before the deadlines. At this point after two prior programs, we're probably starting to pick up procrastinators now. A deadline tends to stop that."

In just the weekend right before the September 9 deadline for the previous OVDP program, his firm saw eight out of the 60 disclosures that came in for the entire period that the program was open.

"Since that deadline, we've had several people who came in who made disclosures because they were told in some manner that their name was about to be released by their banking institution," said McKenzie. "This new program gives us a great deal of certainty about what might occur because the IRS has made it clear that those who came in during the gap from September to January now will be treated under the January program, so that part of the program was good. There's certainty. We know exactly what penalties people potentially face, and we can quantify that for our clients."

Even though clients may initially balk at the amount of money they will need to pay, he explains to them that if they are at high risk, receiving a letter from the IRS that the agency won't prosecute them has a great deal of value.

"This may not be about the money," said McKenzie. "It could be about whether you're one of the lucky, chosen few who gets indicted."

For people in a position where the problem seems more like a case of ignorance of U.S. tax laws, that might be less of a motivator. For example, people who are dual citizens in Canada or who simply inherited accounts from their grandparents might be viewed more sympathetically.

"The problem so far has been the one size fits all approach of the IRS," said McKenzie. "You may recall that during the 2011 program they created this concept of 'opt out.' They had this set of penalties that you would incur if you participated in the program, but if you thought you could establish that you did not have an intentional violation and should be subject merely to the negligence penalty, you could say, 'I'm not going to accept the program. I'm going to opt out.' You wouldn't create any danger of prosecution."

But if the IRS thinks the slip-up was intentional, then the taxpayer could lose the benefit of the penalty under the program and the IRS could enforce a 50 percent penalty of the amount in the account. The penalty was 25 percent for people over \$75,000 under the 2011 version, McKenzie noted, which has now gone up to 27.5 percent under the 2012 version. But it's still a gamble. If the IRS doesn't agree that the oversight was unintentional, the taxpayer could end up owing a whole lot more money.

## 5 Comments

jwellman

Thanks for you comments, and I take your points on board with respect.

Yours, (and I don't mean this in a disparaging way) is a typical American provincial view. Since America is exceptional, why would you want to be anywhere else? Not paying income taxes for your citizenship "services" is somehow unpatriotic, and if you don't like it, renounce. I lived in Kansas once. I understand that view.

So easy to say, "renounce", but so difficult in practice both emotionally and bureaucratic process wise. It is irrevocable, and very expensive. It should not be a necessary requirement, but never mind. That discussion is for another day. I accept that this is how you feel. Nothing I say here, will change your mind, but I might try to get you to consider some of the alternatives to that thinking with more reading on the subject.

The Economist has written about this recently. Google "In praise of a second (or third) passport."

There you will read some pretty good arguments about the value of multiple passports in this interconnected financial world. (btw, I only have one.) The Economist points out...

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"In others, such as America, it may be an accident of birth, with no conscious choice involved. Rather than making a fetish out of passports, a better approach would be to use residence (especially tax residence) as the main criterion for an individual's rights and responsibilities. "

Also from another article called "Dutchman grounded" it writes...

"America's unusual requirement that its passport-holders pay it tax no matter where they live gives many qualifying residents good reason not to apply."

I would suggest that your views on citizenship and "services" taxation, is a "fetish" and a real negative for America's interests abroad.

But read both articles, and in fairness, I might point you to the comment section, as there is lots of debate from people around the world about the value of multiple passports. You might find some to support your view, but just absorb the debate with an open mind.

I think the US is misappropriating energies perusing Expats for income taxes and the revenues will be a pittance for the effort. It does continue to have long term unintended negative marketing impacts and decreases export led job creation in the Homeland. You need lots of US salesmen living overseas to promote your products, and current policies discourage that.

For purely an economic reason - Jobs, the US should be encouraging more Expats to live abroad, as it creates more export jobs for US citizens at home. The US should be doing everything it can to make that easier, not more cumbersome with its endless forms, reporting requirements and draconian penalties for failure. To your point on the benefit of all those military bases around the world: Some would say that is not a benefit or a service, but a huge liability. The US asserting itself into other countries business and trying to play the world policeman comes with a huge cost! It is a BIG contributor to the current US deficit. Its wars of pre-emption have drained the treasury. I am not sure that it can pay for it on the backs of Expats living overseas, who by living outside the US media cocoon see these mis-adventures (services) differently than those in Kansas.

So, I would rather have the US send out Expat businessman to live in the world armed with purchase orders in brief cases, rather than soldiers providing "services" from tank turrets with guns, or filling the sky with drones!

There is nothing about the current citizenship taxation model that encourages that, and I would argue, actively discourages it due to the complexity, double taxation, penalty risk, and huge compliance cost. Corporations do not hire Americans overseas, for all these reasons and more, as they are just too expensive. And no, the income exclusion and foreign tax credit does not offset the cost! That is another myth, but I have hit the comment section character limit, so no space to debunk that one. :)

Posted by: Just Me | January 21, 2012 1:20 PM

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Mr. Wellman,

An interesting and I don't entirely disagree with you but I would like to correct a few misconceptions I think you have:

1. Protection - the only protection the US Embassy can offer if you are detained or arrested in a foreign country is the right to visit you in jail and help you find an English-speaking local lawyer. In a few special cases like the hikers in Iran the U.S. gov did more. However I live in France and I sincerely doubt that the Embassy folks will be able to do a darn thing for me and I doubt they would seriously consider annoying an ally by sending in the Marines on behalf of little old me (I'm an IT manager). I'm pretty much on my own and I understand that and act accordingly.

2. Services - I want more services. Right now the consulate is pretty limited to helping tourists, issuing passports (for which I pay a hefty fee) and offering tax advice. For the last there is an IRS office in Paris (alas I don't live in Paris so I'd have to travel to see them) but they have very limited office hours, they get both French and American holidays off and they only take phone calls at certain times of the day/days of the week. I'd like to see much more. Voter help, for example, or more assistance for long-time expats who get into some

really sticky situations. I have a friend here who was being abused by her spouse, a French national, and she went to the consulate for help. They were very sympathetic but all they could offer her was a loan to buy a plane ticket home. I was talking to a Moroccan friend the other day and their embassy provides "social assistance" to their citizens abroad who find themselves in this kind of situation.

I see your point about the bases but I have to wonder why a country can send people all over the world to show the flag and support U.S. interests but they can't help one American woman in a foreign country get justice for having her head beaten against a kitchen floor.

Posted by: v\_ferauge | January 21, 2012 6:31 AM

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It is not really true that people are now stopping to seek immigrant visa or green card. The would be immigrants are lining up American Embassies to seek entrance to U.S. They know that U.S.A. is still the country of opportunities the results of which they have been able to deposit thousands and millions of dollars to their native land. It is just beyond me that they do not want to pay taxes.

This dual citizenship does not work good because after becoming rich here they renounce US citizenship and forget about the oath and swear of allegiance to USA.

fintax

Posted by: Unknown | January 19, 2012 10:45 AM

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@Just Me- I generally agree with your comments about the IRS, but would argue against you on the citizenship taxation model. US citizenship comes with benefits to citizens no matter where those citizens live. i.e. How many times has the State Department had to emergency evacuate US citizens from this country or that for their own protection? Should they not pay their share to the government who still protects them abroad? We have to pay for those embassies and military bases around the world somehow! How many military bases does Australia or New Zealand have around the world? Exactly. It's not just the taxation model that is different from any other country in the world. So yes, the US asserts its right to keep its Citizens under "servitude" to the IRS no matter where in the universe they live...ONLY because that person also CHOSE to keep their US servitude..., or, uh, citizenship, be it on the Moon, Mars, Canada or New Zealand.

Also, your example of switching between California & Kansas holds little water because the previous state is no longer providing services per se after that person moved. The US is, arguably, providing service to citizens no matter where they live. Again, US citizenship knows no boundaries. So why should the taxation or paying of those benefits? Additionally, you never mentioned the foreign income exclusion which would exempt most middle class incomes from this problem. If you want to suckle from the teet of the US, you gotta pay for it. I view ex-pats and dual citizens as trying to "date other people" without first ending their marriage. If you want to date other countries, then give up your citizenship, or pay your taxes due if you want to be polyamorous. You shouldn't be given a pass to have it both ways simply because you can afford to do so.

Posted by: jwellman | January 19, 2012 9:19 AM

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Thanks for writing about this story and giving it some sunlight.

The problem for the OVDP program, is that the IRS over reached, assumed all were criminal cheats, designed a penalty program for those who are willful, and would not adjust according when they realized they were netting Minnows and not Whales.

They have lost trust.

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Nina Olsen recognized the unfairness of the program was right to issue her TAD.

Now Shulman has 7 days left to do the right thing, and affirm Nina Olson's it. It is due by January 26th. Will he do it, or just ignore the warning of the harm his agency is doing to the US image abroad and the unfairness of his practices?

He is having impact, but not the one he desires. US Expats around the world, who are now becoming aware of IRS practices and US penalties, are turning into an anti American advertising chorus to all would be immigrant "US Persons" to know the risk before signing up for a Green Card or immigrating to America. It is just not worth the Cost anymore! And the risk is extreme!

Good work Shulman, is this the message you wanted out around the world? "Stay away from America" "Do not become a US Person!"

But the story is more than just a misguided program. IRS VDP overreach is just symptomatic of a basic core problem: The Citizenship taxation Model.

The IRS VDP has had one BIG benefit, (along with all the damage it has done). It has raised awareness that the US income tax model is based upon a misguided policy, and that the US Citizenship taxation model is unique in the world.

Every other OECD country taxes on a territorial system, but the US asserts its right to keep its Citizens under tax a life time payment contract (some would say servitude) to the IRS no matter where in the universe they live, be it the Moon, Mars, Canada or New Zealand. Immigrants aside, it is mostly based upon the lottery of your birth, or your parentage.

If you were born in California and later moved to Kansas, you would not expect California to continue to assert its right to tax you now that you are resident in Kansas, right?

That is a territorial taxation system, that is logical and makes sense, and every country in the whole wide world, except Eritrea, follows it. We keep good company, eh?!

If you move from New Zealand, and take up residency in Australia, New Zealand doesn't tax you on your income in Australia while you are residing there. It does not expect you to file out endless forms or assert huge penalties for not reporting on your normal Australian checking Account back to the NZ IRD. The US, in contrast, wants to penalize you, at a minimum of \$10,000 for each "nonwillful" failure to report your bank account on a FBAR form. The penalties can be as much as 50% of the account if they consider your failure to be willful, and you are guilty until you prove yourself innocent! Lovely, eh?

Finally, there is a very good argument to be made that Citizenship taxation is a job killer for the Homeland.

There is an article that makes a strong case that we should be unloosing the shackles on US citizens abroad, not tightening them down with new laws like FATCA and VDP witch hunts to exposure, penalize and tax US Citizens abroad normal offshore accounts and income via the Voluntary Disclosure programs.

A Winning Formula for Economic Growth: Americans Abroad = Increased Exports = Domestic Jobs

Google that title, and you will end up on a web page of The Association of American Residents overseas (AARO). Also, American Citizens Abroad (ACA) has lots of material and information on these subjects.

Thank you for your efforts to understand this much ignored and misunderstood subject.

Posted by: Just Me | January 19, 2012 4:18 AM

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