

MSP  
#15**Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs****RESPONSIBLE OFFICIALS**

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**DEFINITION OF PROBLEM**

In recent years, the IRS has devoted substantial resources to improving international tax administration and responding to the challenges of globalization.<sup>1</sup> However, the IRS continues to focus on stepped-up enforcement without adequate servicewide coordination, and with no corresponding increase in service to millions of individual international taxpayers.<sup>2</sup> The National Taxpayer Advocate's 2011 Annual Report to Congress identified six serious problems facing these taxpayers in understanding and meeting their federal tax obligations.<sup>3</sup>

A 2012 IRS research study of international taxpayers shows that this group remains underserved, desires self-service options, and may experience a higher rate of post-filing problems than the general taxpayer population.<sup>4</sup> Among those who file, many do not have an adjusted gross income (AGI) high enough to generate a tax liability. About 82 percent of U.S. taxpayers abroad did not have a U.S. liability.<sup>5</sup> Others are afraid to file, being uncertain about filing requirements or intimidated by the complexity of U.S. tax laws. Confusion and frustration about U.S. tax requirements, the risk of heavy penalties, and the corresponding compliance burden may cause some taxpayers to give up their U.S. citizenship. Expatriations increased more than sixfold between calendar years (CYs) 2008 and 2012.<sup>6</sup>

While international taxpayers grapple with compliance challenges and inadequate service, the IRS has been slow in taking specific steps to meet their needs and ease their compliance burdens, saving enforcement resources to address egregious noncompliance. We

<sup>1</sup> See, e.g., IRS, *The Budget in Brief*, FY 2011; IRS, *The Budget in Brief*, FY 2010; Pub. L. No. 111-117 (Dec. 16, 2009); Pub. L. No. 112-10 (Apr. 15, 2011).

<sup>2</sup> See National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 30, fn. 183 and 184. International taxpayers are broadly defined to include U.S. individuals working, living, or doing business abroad, U.S. entities doing business abroad, foreign individuals working or doing business in the U.S., and foreign entities doing business in the U.S.

<sup>3</sup> See National Taxpayer Advocate 2011 Annual Report to Congress 129-272.

<sup>4</sup> IRS, Wage and Investment Division (W&I) Research & Analysis, Research Study Report, *2012 Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors* (Aug. 2012) (2012 WIRA Research Study). Compared to all tax returns, international individual returns have almost twice the math error rate and are less likely to be filed electronically. *Id.* at 9.

<sup>5</sup> 2012 WIRA Research Study 23-24. See also National Taxpayer Advocate 2011 Annual Report to Congress 155-156.

<sup>6</sup> IRS, *Quarterly Publications of Individuals Who Have Chosen to Expatriate, as Required by Section 6039G, 2008-2011*. These publications contain the name of each individual losing U.S. citizenship (within the meaning of IRC §§ 877(a) or 877A). For purposes of these listings, long-term residents, as defined in § 877(e)(2), are treated as if they were U.S. citizens who lost citizenship. The publications do not distinguish between former U.S. citizens and long-term residents.

have identified the following problems with the IRS's approach to improving international taxpayer service:

- Delays in developing specific recommendations to improve service based on cross-functional team findings;
- The lack of a strategic plan to address persistent compliance challenges;
- The absence of a timeline to implement recommendations of the 2012 IRS research study;
- The insufficient use of modern technology as a more efficient method of delivering services and providing information, including virtual face-to-face (VFTF) assistance and online services; and
- The lack of simplified filing and self-correction options for international taxpayers.

## ANALYSIS OF PROBLEM

### Background

In recent years, globalization has pushed an increasing number of individual taxpayers (including entrepreneurs and small businesses) to seek economic opportunities abroad. It also has increased competition among tax administration agencies for tax bases and sources of revenue. Both taxpayers and the government can benefit from tax systems that are simple to administer and have high rates of compliance.<sup>7</sup> For this reason, 33 countries lowered the tax burden and made compliance easier by introducing or enhancing electronic systems and reducing the frequency of filing or merging or eliminating duplicative reporting.<sup>8</sup> In contrast, World Bank studies consistently rank the United States between 65th and 69th in time spent to comply among 183 countries surveyed.<sup>9</sup>

The complexity of international tax law, combined with the administrative burden placed on international taxpayers, creates an environment where taxpayers who are trying their best to comply simply cannot. For some U.S. taxpayers abroad, the requirements are so confusing and the compliance burden so great that they give up their U.S. citizenship.<sup>10</sup> Overall, nearly 7,000 U.S. citizens renounced citizenship from calendar year (CY) 2005 through third quarter of CY 2012.<sup>11</sup> The number of expatriations increased over sixfold from 231 in CY 2008 to about 1,800 in CY 2011, as shown on Figure 1.15.1

<sup>7</sup> The World Bank, The International Finance Corporation (IFC), and PricewaterhouseCoopers (PwC), *Paying Taxes 2012, The Global Picture* 15 (2011). This is the seventh year that the *Paying Taxes* indicators have been included in *Doing Business* project run by the World Bank Group.

<sup>8</sup> World Bank, IFC, and PwC, *Paying Taxes 2012, The Global Picture* 15-18 (2012).

<sup>9</sup> See The World Bank, IFC, and PwC, *Paying Taxes, The Global Picture* (2009-2012).

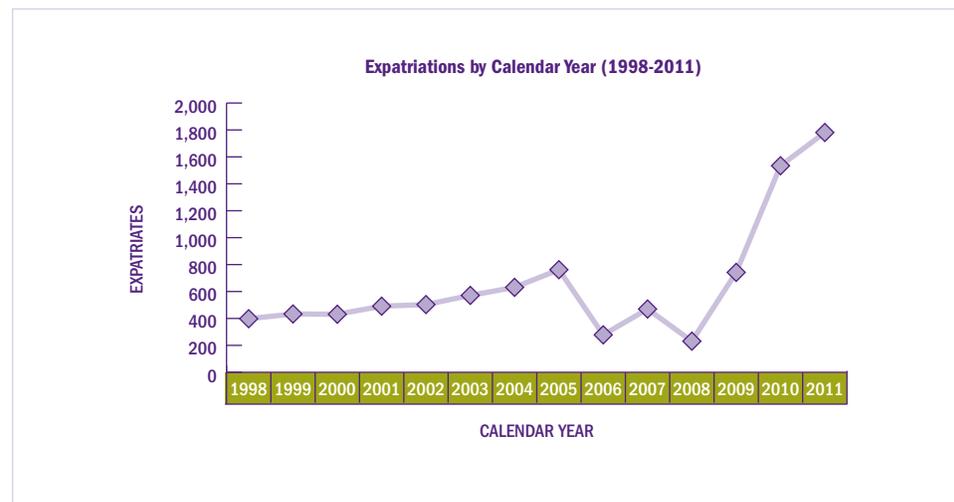
<sup>10</sup> National Taxpayer Advocate meeting with the U.S. Ambassador to Switzerland (Feb. 4, 2011). See also Brian Knowlton, *More American Expatriates Give Up Citizenship*, N.Y. Times, Apr. 25, 2010; Helena Bachmann, *Why More U.S. Expatriates Are Turning In Their Passports*, Time World, Apr. 20, 2010.

<sup>11</sup> IRS, *Quarterly Publications of Individuals Who Have Chosen to Expatriate, as Required by Section 6039G, CYs 2005 - 2012* (through third quarter of CY 2012). These publications contain the name of each individual losing U.S. citizenship (within the meaning of IRC §§ 877(a) or 877A). For purposes of these listings, long-term residents, as defined in § 877(e)(2), are treated as if they were U.S. citizens who lost citizenship. The publications do not distinguish between former U.S. citizens and long-term residents.

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below. Expatriations dramatically increased after CY 2009, coinciding with increased IRS enforcement of the Foreign Bank Account Report (FBAR) penalty and confusing offshore voluntary disclosure initiatives that appeared overly harsh to taxpayers who inadvertently violated the rules.<sup>12</sup>

**FIGURE 1.15.1, Expatriations in CYs 1998-2011**



### Profile of International Taxpayers

In response to concerns the National Taxpayer Advocate expressed in prior Annual Reports to Congress, and in support of the IRS Multiyear Servicewide Approach to International Tax Administration, Wage and Investment Research & Analysis (WIRA) in 2012 completed a comprehensive study (hereinafter “WIRA Research Study”) of the service needs and filing issues of international individual taxpayers.<sup>13</sup> The study found that in comparison to the general filing population, international taxpayers (defined for the purposes of the study as individuals living outside the U.S.) reported lower income, fewer refund returns, and a larger number of zero balance due returns.<sup>14</sup> Wage earners, however, reported significantly

<sup>12</sup> See Most Serious Problem: *The IRS’s Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts, infra/supra*. See also National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 21-31; National Taxpayer Advocate 2011 Annual Report to Congress 171-272.

<sup>13</sup> 2012 WIRA Research Study 7. The research study included focus groups with tax practitioners who serve international taxpayers, demographic and tax filing profiles of international taxpayers over various tax years, multiple interviews with tax attachés working with taxpayers overseas, interviews with multinational companies based in the U.S. employing U.S. citizens overseas, the 2009 IRS Survey of International Taxpayers, collaboration with custodians of Department of State Passport Data and Certificate of Loss Nationality Data, analysis of the IRS Printing and Postage Budget Reduction (PPBR) project on direct mailings to embassies and taxpayers living abroad, and the 2011 IRS Survey of Individuals Living Abroad.

<sup>14</sup> For the purposes of the 2012 study, WIRA defined “international taxpayers” as individuals living outside the United States, and include filers of Puerto Rican and non-resident alien returns. *Id.*

higher levels of income than all international filers.<sup>15</sup> The study indicates that approximately 64 percent of all international taxpayers reported an adjusted gross income (AGI) of \$25,000 or less with a median AGI of \$11,770, as shown on Figure 1.15.2 below.<sup>16</sup>

**FIGURE 1.15.2, Adjusted Gross Income of Total International Returns for Tax Year 2010<sup>17</sup>**



Nearly 58 percent of wage earners who claimed foreign earned income exclusion reported foreign wages in excess of \$50,000, with a median wage of \$65,400. The maximum foreign income exclusion for TY 2010 was \$91,500, and the reported median for this exclusion was \$63,887.<sup>18</sup> Only 58 percent of all international tax returns resulted in refunds, compared to 80 percent of all individual returns, while 24 percent were filed with a zero balance due, compared to just four percent of all individual returns. This difference in the percentage of zero balance returns indicates that the AGI reported by international taxpayers is often not high enough to generate a tax liability.<sup>19</sup>

#### **The Creation of a Cross-Functional International Individual Taxpayer Assistance Team May Help to Better Coordinate International Taxpayer Service.**

In June 2012, the IRS's Large Business & International Division (LB&I), Wage & Investment Division (W&I), and TAS created the International Individual Taxpayer Assistance Team (IITA) to develop international taxpayer service initiatives based on the National Taxpayer

<sup>15</sup> 2012 WIRA Research Study 23. International filers include three groups: U.S. civilian taxpayers abroad, military personnel stationed abroad, and non-resident Aliens. U.S. taxpayers abroad were identified by the Universal Location Code (ULC) of 98 and a null value in the STATE variable. Military filers were identified by their tax return having an Army Post Office/Fleet Post Office (APO/FPO) address. Non-resident aliens were identified by the document code (DOC\_CD) of 72 or 73. *Id.* at Appendix O.

<sup>16</sup> The median AGI calculated for total international returns excludes returns filed on Form 1040PR or 1040SS, since neither of these forms has a line item for AGI. International wages can be reduced by claiming the foreign earned income exclusion on Form 2555, *Foreign Earned Income Exclusion*.

<sup>17</sup> 2012 WIRA Research Study 22.

<sup>18</sup> Of international taxpayers who reported foreign income, the median wage reported on line 7 of Form 1040 was \$80,688.

<sup>19</sup> 2012 WIRA Research Study 31-32.

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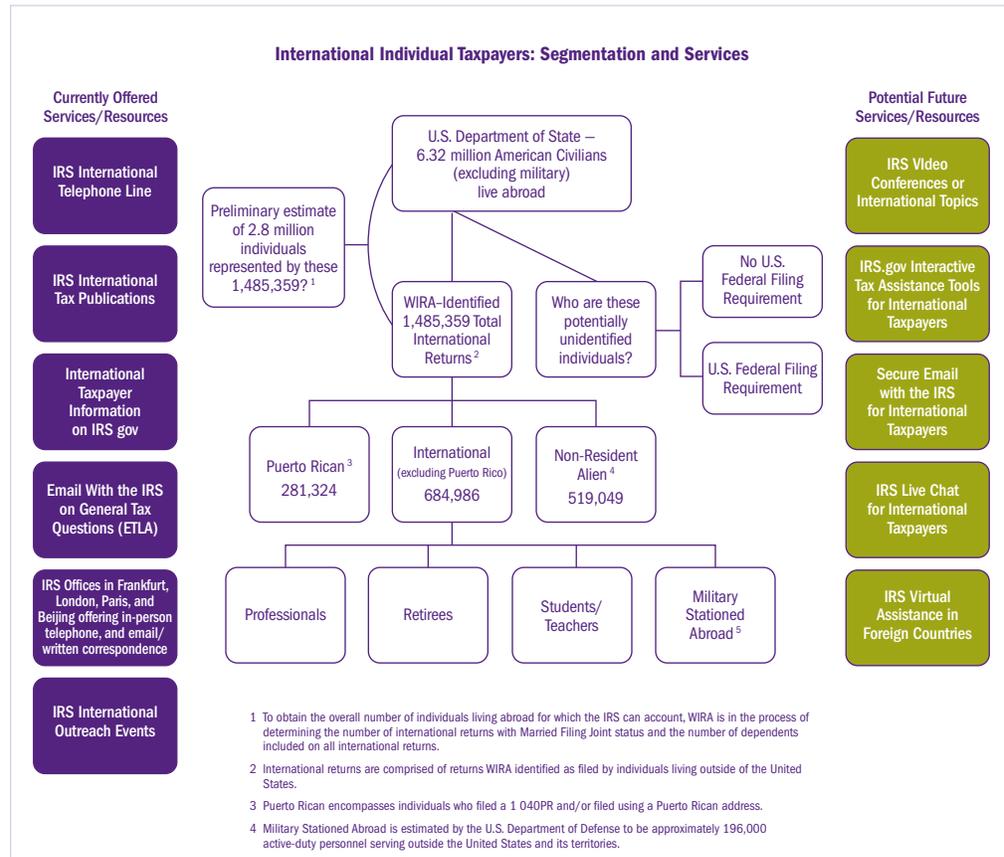
Advocate's recommendations and the 2012 WIRA study.<sup>20</sup> The IRS Office of Online Services joined the group in August 2012. IITA has the following objectives:

- Identify international taxpayer groups with similar characteristics;
- Identify needs of these groups;
- Identify existing channels for assistance for these groups;
- Identify service gaps for these groups;
- Identify risk factors for service gaps;
- Prioritize taxpayer groups and service gaps based upon risk factors;
- Develop solutions and sort them in a priority order based on importance and resources; and
- Involve LB&I and IRS Office of Chief Counsel experts on tax treaties and international law issues.

The WIRA representative on the IITA team facilitated discussions with other team members to identify groups of international taxpayers, current services and resources, and potential future services and resources, and developed a flow chart, reproduced as Figure 1.15.3 below.

<sup>20</sup> See 2012 WIRA Research Study; WIRA, *Understanding the International Taxpayer Experience: Service Awareness, Use, Preferences, and Filing Behaviors, Research Study Report* (Feb. 2010); W&I, *International Taxpayer Topline Report 5*, Pacific Consulting Group (Dec. 2009); WIRA, Research & Analysis, Focus Group Testing Report: *Customer Service Needs of U.S. Taxpayers Living Abroad, Project # 3-08-07-S-017T* (Dec. 2008).

**FIGURE 1.15.3, International Individual Taxpayers: Segmentation and Services**



Most Serious Problem

The National Taxpayer Advocate commends the IRS for this effort and recommends making the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports to Business Operating Division (BOD) executives through the existing Services Committee.<sup>21</sup> We encourage the team to formulate recommendations based on its findings and the WIRA study, and move forward to present them to the Services Committee.

Even though the creation of the team is a positive step, the team is moving slowly toward developing specific recommendations and a plan for their implementation. In the meantime, international taxpayers are still experiencing compliance challenges and difficulties with accessing IRS services. From the taxpayer’s perspective, any improvement in service

<sup>21</sup> The Services Committee serves as the governing body for major service investment and management decisions at the IRS. It discusses and makes decisions or recommendations on items related to taxpayer service investments, resource allocations, and program and process management in the context of IRS-wide strategic planning and budgeting (e.g. Modernization Vision and Strategy, the IRS budget, relevant research conducted by the Office of Research, Analysis, and Statistics and the Operating Divisions, etc.). IRM 22.24.1.4 (June 18, 2012).

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has been minimal. TAS urges the team to move quickly in tailoring its existing services and recommending future services to meet the needs of these taxpayers.

### The 2012 IRS Study Confirmed That Challenges Persist for International Taxpayers.

The 2012 WIRA research study confirmed that international taxpayers still face many compliance challenges. Most often, international taxpayers cited concern about the complexity of and confusion over international tax law, dissatisfaction with not receiving filing materials, excessive use of jargon or unclear language in IRS letters, publications, and forms, and difficulty finding information on IRS.gov.<sup>22</sup> Other problems described in the study include:

- *The inability to file electronic returns and to use Free File Fillable Forms (FFFF) for electronic filing.*<sup>23</sup> The IRS does not allow electronic filing of the 1040NR series of returns for nonresident alien taxpayers. Nor can U.S. taxpayers abroad use FFFF for electronic filing.
- *Difficulties in getting personal service.* Face-to-face assistance for international taxpayers is almost nonexistent, as they can only use four tax attaché offices in Beijing, Frankfurt, Paris, and London which receive high volumes of requests for help each month.<sup>24</sup>
- *Difficulties in obtaining tax information.* Taxpayers abroad can only research a limited number of FAQs and pages on IRS.gov. In addition, the Interactive Tax Assistance (ITA) tool does not deal with international topics at all. The four tax attachés hold outreach events that cover important topics for international taxpayers, such as filing obligations, Individual Taxpayer Identification Number (ITIN) applications, the foreign earned income exclusion, FBAR obligations,<sup>25</sup> and avoidance of double-taxation.<sup>26</sup> These events are usually filled to capacity.<sup>27</sup>
- *Difficulties obtaining tax forms and publications.* W&I's decision to stop mailing tax forms and instructions to individuals worldwide created an unprecedented number of walk-ins, calls, and emails at tax attaché posts requesting forms, instructions, and publications.<sup>28</sup> The resulting burden was especially hard for elderly taxpayers with dial-up or no access to the Internet and those with slow connection speed.<sup>29</sup> Many could not download large documents and remained uninformed about new laws and reporting

<sup>22</sup> 2012 WIRA Research Study 48.

<sup>23</sup> Only 30 percent of international returns were filed electronically, compared to 81 percent of domestic returns. *Id.* at 21.

<sup>24</sup> For example, during the first half of FY 2012, the London post had answered 1,730 phone calls, provided services to 1,939 walk-in taxpayers, and responded to 1,349 letters/faxes. *Id.* at 28.

<sup>25</sup> Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*.

<sup>26</sup> For a detailed discussion of ITIN issues, see Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Defer Fraud, infra/supra.*

<sup>27</sup> 2012 WIRA Research Study 29.

<sup>28</sup> In FY 2011, under the Printing and Postage Budget Reduction (PPBR) plan the IRS eliminated the direct shipments of Package 7 (containing Forms 1040, 1040-V, 1116, 2106, 2555, 2555EZ, 3903, 6251, TD F 90-22, Schedules A, B, C, D, E, L, M, and SE, and Publication 54) to international taxpayers. Nor does the IRS ship this package to U.S. embassies in foreign countries.

<sup>29</sup> 2012 WIRA Research Study 33 (Interviews with Tax Attachés in International IRS Posts).

requirements for taxpayers with foreign financial assets because they relied on the IRS to mail them the forms and publications they needed.<sup>30</sup>

### **Technology Can Provide Cost- Effective Solutions to Many International Compliance Challenges.**

Modern technology can be a more efficient method of delivering services and providing information to taxpayers.<sup>31</sup> The 2011 IRS Survey of Individuals Living Abroad shows that roughly two-thirds of international taxpayers prefer self-service channels and online services.<sup>32</sup> Based on survey responses, WIRA recommends:<sup>33</sup>

- *Improvements to IRS.gov* in terms of searchability, organization, and content of international tax topics;
- *Improvements to other online resources* by adding international topics to the ITA application, creating online chat, expanding email options, and revising the Free File Fillable Form program to accept foreign addresses;<sup>34</sup>
- *Virtual assistance for taxpayers in foreign countries* through videoconference technology, beginning with Canada and Mexico;<sup>35</sup> and
- *Virtual outreach to taxpayers abroad* by IRS employees in the United States.<sup>36</sup>

While the National Taxpayer Advocate strongly supports these recommendations, the IRS still needs to develop a systematic, structured plan for providing these and other virtual services and informing the public about their availability. In addition, the IRS should not limit improvements to online services but should also reestablish services that other international taxpayers need, such as mailing forms and publications and holding in-person outreach events.

<sup>30</sup> The Foreign Account Tax Compliance Act (FATCA) enacted in 2010 requires that Form 8938 be filed by taxpayers who meet certain criteria regarding foreign assets beginning in January 2012. See also Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*, *infra/supra*.

<sup>31</sup> Organization for Economic Cooperation and Development, Forum on Tax Administration, Working Smarter in Revenue Administration—Using Demand Management Strategies to Meet Service Delivery Goals 5 (Jan. 2012).

<sup>32</sup> WIRA Research Study 40-41.

<sup>33</sup> Based on the survey results, the WIRA study recommended the IRS consider these areas, but specified that the IRS should first consider the feasibility of the actions in the second, third and fourth bullets.

<sup>34</sup> Survey data and interviews with tax attachés revealed that the most frequent questions by international taxpayers deal with the Individual Taxpayer Identification Number (ITIN) application process and requests for forms and publications. Other common topics are tax law questions; filing obligations; non-filer questions; accounts and notices; Form 8938, *Statement of Specified Foreign Financial Assets*; *FBAR, Report of Foreign Bank and Financial Accounts*; foreign earned income exclusion, tax treaties, and tax preparation.

<sup>35</sup> Virtual face-to-face service delivery enables taxpayers to interact directly with IRS employees using videoconferencing equipment. This recommendation adopts the recommendation of the National Taxpayer Advocate to expand the VFTF pilot program to international taxpayers. For a detailed discussion of virtual service, see Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-To-Face Service and Should Expand its Initiatives to Meet Taxpayer Needs and Improve Compliance*, *infra*.

<sup>36</sup> The IRS video portal ([www.irsvideos.gov](http://www.irsvideos.gov)) does not contain international tax topics for individual taxpayers. TAS suggests that the IRS add information on these issues.

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### The IRS Could Significantly Improve Future Compliance by Simplifying Reporting Requirements, Sending Targeted Soft Notices, and Expanding Self-Correction Options.

Many international taxpayers remain confused about the requirements for return filing and reporting foreign financial accounts and assets, or are intimidated at the prospect of having to come into or return to compliance.<sup>37</sup> Many appear to believe the IRS will always seek to apply the maximum penalties, regardless of the situation, even to “benign actors” who inadvertently violate the rules.<sup>38</sup> Absent clear procedures that provide an incentive for non-filers to come 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. While an estimated 6.32 million U.S. citizens reside abroad, the IRS received only about 700,000 returns from these individuals in TY 2010.<sup>39</sup> Despite publicizing the reporting requirements for foreign financial accounts for years since 2007, the IRS received only 741,249 FBARs in 2011.<sup>40</sup>

The IRS does not have sufficient resources to identify or take enforcement actions against all non-filers. Moreover, this type of action may lack economic sense given that the AGI reported by international taxpayers is often not high enough to generate a tax liability. According to the 2012 WIRA research study (and similar TAS findings in the 2011 Annual Report to Congress), more than 80 percent of U.S. taxpayers abroad had no U.S. tax liability.<sup>41</sup> For taxpayers subject to foreign tax at rates higher than the U.S. effective tax rate and thereby having no liability, the IRS could develop simplified tax and information reporting options modeled after the new online FBAR form.<sup>42</sup>

The IRS also plans to sample filing compliance of U.S. citizens abroad through direct compliance contacts and to begin sending soft notices to non-filers based on passport data from the Department of State.<sup>43</sup> All U.S. passport applicants must provide a taxpayer identifying number (TIN) and identify any foreign country in which they reside.<sup>44</sup> The State

<sup>37</sup> By not filing tax returns, many of these taxpayers may be forfeiting significant tax benefits, such as foreign earned income and foreign housing exclusion or deduction. However, these provisions are not automatic, *i.e.*, a taxpayer must file an election. See also Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts*, and Form 8938, *Statement of Specified Foreign Financial Assets* (commonly known as FATCA); Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts* (commonly known as FBAR).

<sup>38</sup> National Taxpayer Advocate 2011 Annual Report to Congress 133-134; 191-205. See also Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*, *infra/supra*. Most international penalties are related to information returns and are civil penalties that are not based on the amount of underpayment, *e.g.*, for failure to file information returns under 31 U.S.C. § 5321(a)(5) and IRC §§ 6038, 6038A, 6038B, 6038C, 6039F, 6046, 6046A, 6048. See also IRC §§ 6038D, 6662(b)(7); 31 U.S.C. § 5321(b)(1). These penalties may range from \$10,000 per violation to the greater of \$600,000 or 300 percent of the foreign account balance for willful failures continuing over a six-year period.

<sup>39</sup> 2012 WIRA Research Study 13, 24.

<sup>40</sup> IRS response to TAS information request (July 27, 2012).

<sup>41</sup> 2012 WIRA Research Study 23-34.

<sup>42</sup> See Financial Crimes Enforcement Network (FinCEN), BSA E-Filing System, *File an FBAR*, available at [http://bsaeiling.fincen.treas.gov/Enroll\\_Individual.html](http://bsaeiling.fincen.treas.gov/Enroll_Individual.html) (last visited Dec. 21, 2012).

<sup>43</sup> LB&I request to change the corrective action due date (Sept. 24, 2012), TAS SharePoint (tracking annual report to Congress recommendations), 2009 Rec 7-1.

<sup>44</sup> See generally IRC § 6039E(b).

Department shares this information with the IRS, which can match it with its own records to verify filing compliance. Because all U.S. citizens abroad are required to file returns regardless of their residency status, the IRS plans to use soft notices to remind them of these obligations.

While we generally support this initiative, the IRS should vet it thoroughly with stakeholders, including TAS, before proceeding. In addition, for this initiative to succeed, it should be combined with a self-correction option. This option could be a voluntary compliance program (VCP) that combines simplified filing with relief from all penalties, at least for international taxpayers who would not have tax liability (after applying the foreign earned income exclusion and foreign tax credit).<sup>45</sup> This type of program can establish per-country filing thresholds based on AGI. It would allow U.S. taxpayers residing in those countries to file a simplified, combined tax and information return form online based on their income in a foreign jurisdiction, especially if the country has an effective income tax rate higher than that of the U.S.<sup>46</sup> For non-filers whose filing would lead to a tax liability, the IRS can use the recently-announced Streamlined Nonresident Filing Initiative,<sup>47</sup> and increase the threshold from the current \$1,500 of tax due to \$10,000.<sup>48</sup> This approach could create a win-win situation — substantially decreasing burden for U.S. taxpayers abroad and encouraging benign non-filers to correct inadvertent violations without draining IRS resources, while freeing up IRS enforcement resources to address bad actors with substantial tax liabilities.

## CONCLUSION

In conclusion, the National Taxpayer Advocate preliminarily recommends that the IRS:

1. Make the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports and formal recommendations to the IRS Services Committee, including items for the IRS Strategic Plan and Servicewide Approach to International Tax Administration.
2. Develop a systematic and structured plan for implementing the 2012 WIRA Research Study recommendations and inform the public about the timeline.

<sup>45</sup> According to the 2012 WIRA research study (and similar TAS findings in the 2011 Annual Report to Congress), more than 80 percent of U.S. taxpayers abroad claiming the foreign earned income exclusion (FEIE) and foreign tax credit did not have U.S. tax liability.

<sup>46</sup> The IRS has broad authority to prescribe the time and manner in which taxpayers file returns and the format of various required forms. See generally IRC §§ 6001, 6011. See also free and easy electronic filing of the FBAR Form, Financial Crimes Enforcement Network (FinCEN), BSA E-Filing System, File an FBAR, available at [http://bsaeifiling.fincen.treas.gov/Enroll\\_Individual.html](http://bsaeifiling.fincen.treas.gov/Enroll_Individual.html) (last visited on Sept. 28, 2012).

<sup>47</sup> IRS, *New Filing Compliance Procedures for Non-Resident U.S. Taxpayers* (first posted June 28, 2012), available at <http://www.irs.gov/Individuals/International-Taxpayers/New-Filing-Compliance-Procedures-for-Non-Resident-U.S.-Taxpayers> (last visited Dec. 21, 2012).

<sup>48</sup> The National Taxpayer Advocate previously recommended increasing the \$1,500 threshold to the “substantial understatement” threshold. National Taxpayer Advocate FY 2013 Objectives Report to Congress 24. Individuals who owe less than the greater of 10 percent of the tax required to be shown on the return or \$ 5,000 may not have a “substantial understatement,” and thus, may not be subject to an accuracy-related penalty, particularly if a negligence penalty does not apply. See generally IRC § 6662(d).

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3. Reinstate mailing of forms and publications to international taxpayers and U.S. embassies and consulates.
4. Allow electronic filing of 1040NR series and ITIN applications for nonresident alien taxpayers, at least those not claiming a refund.
5. Develop a method of simplified tax and information reporting online, modeled after the new online FBAR form for taxpayers incurring foreign taxes higher than the U.S. effective tax rate — resulting in no tax liability.
6. Establish a voluntary compliance program for international individuals, including a combination of simplified filing and relief from all penalties for taxpayers who have no liability.
7. Increase the threshold for the Streamlined Nonresident Filing Initiative from \$1,500 of tax due to \$10,000.

### IRS COMMENTS

The IRS recognizes the need to increase internal IRS coordination of international taxpayer service. We have made a number of improvements in this area and continue to look for opportunities to improve service delivered to this taxpayer base.

In 2010, the IRS reorganized the office of the Deputy Commissioner, International (Large Business & International) to align international technical professionals within a single office to better identify, address and resolve significant compliance issues faced by both individuals and businesses operating across borders. In 2011, LB&I further realigned to form the position of Assistant Deputy Commissioner, International, responsible for overseeing treaty assistance and interpretation, treaty negotiations, exchange of information, international programs, overseas operations, and service wide coordination. The Transfer Pricing Operations unit was also formed to manage transfer pricing compliance and promote strategic case development across the organization. This further realignment was driven by LB&I's continuous focus and recognition of the high complexity of the tax laws applicable to taxpayers engaged in international activities and the commensurate challenges to the IRS in communicating and enforcing those legal complexities. The Deputy Commissioner, International, is responsible for coordinating IRS efforts in this area across all IRS Business Operating Divisions to ensure that the IRS's international strategy is aligned, balanced, and coordinated.

Improving taxpayer service to U.S. taxpayers who work, live, and conduct business abroad is an important strategic goal for the office of the Deputy Commissioner, International, and the IRS in general. As part of FY 2013 priorities, the International Executive team is committed to coordinating closely with W&I, Online Services, the Return Preparer Office, Associate Chief Counsel International (ACCI), and Taxpayer Advocate Service to improve access to taxpayer service with respect to international tax challenges faced by individual

taxpayers. We will consider the views included in the National Taxpayer Advocate's Annual Report in this effort.

### **Current IRS Efforts**

The IRS has taken a number of steps throughout the organization to better coordinate delivery of service to international taxpayers.

#### *International Individual Taxpayer Assistance Team*

In June 2012, a cross-functional International Individual Taxpayer Assistance Team was formed to better coordinate and develop international taxpayer service initiatives. This team consists of LB&I, W&I, ACCI, TAS, and Online Services. The IRS recognizes the need and importance of having a team focused on international taxpayers operating in a complex global tax environment. The IITA is currently in its pilot stage, and its effectiveness will need to be evaluated and measured. After the completion of this evaluation, the IRS will consider whether the IITA should become permanent with a formal charter.

#### *W&I Study of Individuals Living Abroad*

Building on the success of the first phase of international taxpayer research resulting in the 2010 *Understanding the International Taxpayer Experience Research Study Report*, Wage and Investment Research & Analysis kicked off a second phase of research to further develop and refine the IRS's understanding of international taxpayer service needs, preferences, and behaviors. The focal point of this second phase of research is the 2011 *IRS Survey of Individuals Living Abroad*, with its specific interest in international taxpayers' experiences, expectations, and preferred alternatives to an IRS international telephone line.

In an effort to reach a wider population of international taxpayers, WIRA used groundbreaking research methodology and resources, including the IRS non-filer database, U.S. Department of State Passport data, Certificate of Loss of Nationality data, and expatriate affinity groups to administer the 2011 survey to international filers and non-filers, non-resident aliens, overseas military personnel, and expatriates. A comprehensive report of the survey findings, the 2012 *Taxpayer Experience of Individuals Living Abroad: Service Awareness, Use, Preferences, and Filing Behaviors*, was completed and released in August 2012.

The report concluded that there is consistency with each international taxpayer in terms of confidence in the information received from the phone versus the website, their opinions of visiting IRS.gov prior to calling the IRS, and also in the opinions of the hours of operations of the telephone lines. In summary, there was consistent alignment in what the international taxpayers say they want, say they use, and actually use.

The WIRA report revealed several areas for potentially improving the taxpayer experience of individuals living abroad, including:

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**(1) Improvements to IRS.gov:** The WIRA study identified improvements to IRS.gov as an area of consideration, with an emphasis on searchability, organization, and content. In August 2012, the IRS launched a completely redesigned IRS.gov. The redesigned site includes a new intent-driven navigation system (*e.g.*, filing, payments, refunds) to replace the old system that focused on the type of search (*e.g.*, individual, business, professional). This new platform allows the IRS to deliver more service at a faster pace. With more than two billion page views annually, this update will be a significant help to taxpayers. We recognize that further refinements may be necessary to improve the international portion of the site; hence, the IITA has established this as a priority item in enhancing international taxpayer service.

**(2) Effective Utilization of Online Resources:** The WIRA study suggested that the IRS consider the following items to improve the utilization of online resources by international taxpayers:

- Prioritize the rollout of international tax topics on the Interactive Tax Assistant (ITA) application on IRS.gov. The IRS will consider adding international tax topics to the ITA application by possibly implementing the utilization of decision trees to assist international taxpayers with frequently asked questions.
- Institute online chat and expand email with the IRS as alternative communication channels for individuals living abroad. The IRS continues to consider expanded online chat and email options for taxpayers. However, the protection of private taxpayer information is a major concern of the IRS, and the IRS must ensure that this concern is addressed before online chat can be introduced and email options can be expanded.
- Prioritize the funds needed to make Free File Fillable Forms an electronic tax filing option for everyone. For tax year 2012 (filing year 2013), FFFF will support the use of foreign addresses combined with the electronic filing of forms. As a result, any forms that are included as an FFFF can be e-filed, regardless of the taxpayer address.

Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, and W-7, *Application for IRS Individual Taxpayer Identification Number*, have been identified as candidate forms for electronic filing. A number of factors such as budget, resource availability, and performance improvement releases must be taken into account in determining the sequence of new electronic filing. The IRS will continue to evaluate implementing these two forms into the MeF platform.

**(3) Virtual Assistance for Taxpayers Abroad:** The WIRA study suggested the IRS consider the feasibility of piloting virtual assistance in Canada and Mexico. The IRS piloted virtual service delivery (VSD) at 19 domestic locations for filing year 2012. The pilot program was considered successful and VSD was expanded to an additional 53 domestic locations in October 2012. The IRS will consider the feasibility and benefit of expanding this program to locations outside the United States and will welcome the input of the NTA

to determine the most beneficial locations for providing this service to our international taxpayers abroad.

**(4) Coordination between W&I and LB&I for International Individual Taxpayers:**

The WIRA study mentioned that W&I and LB&I have a common goal of providing exceptional service to our individual taxpayers. The study suggested that W&I could consider involving LB&I employees in selected training classes intended for W&I employees at the Philadelphia International Section and the Austin ITIN Unit. LB&I has begun this collaborative effort with W&I and has participated in discussions to consider the feasibility of this suggestion.

**Improved Taxpayer Service Programs for International Taxpayers**

The following are current taxpayer services offered by the IRS to international taxpayers:

**Streamlined Filing.** The IRS in June 2012 issued IR 2012-65<sup>49</sup> to provide for streamlined filing of certain tax returns. These new Streamlined Procedures apply to non-resident, non-filers whose returns constitute “low risk.” A return will be determined to be “low risk” if it is a simple return with tax due below \$1,500. To qualify, taxpayers must file returns for their three most recent delinquent tax years. Low risk returns will not be subject to either the failure to file a return penalty under IRC § 6651(a)(1) or the failure to pay tax penalty under IRC § 6651(a)(2) or information return penalties (*e.g.*, FBAR penalties). We believe these new Streamlined Procedures accomplish the establishment of a voluntary compliance program for international individuals, including a combination of simplified filing and relief from all penalties for taxpayers who have no liability.

As the National Taxpayer Advocate points out, according to the 2010 WIRA research study, more than 80 percent of US taxpayers abroad had no US tax liability.<sup>50</sup> The IRS continues to monitor feedback from stakeholders, but we do not believe it would be appropriate to raise the ceiling for the streamlined program to \$10,000. A number of factors, including equity and fairness issues for taxpayers living in the US, are relevant.

**Publications.** The IRS has created several publications to assist international taxpayers. Publication 4732, *Federal Tax Information for U.S. Taxpayers Living Abroad*, is a useful resource that is located on IRS.gov and was recently updated (November 2012). There is general information for the international taxpayer on filing requirements, filing deadlines, help with tax questions, common publications, a listing of embassies and consulates with on-site IRS assistance, and other helpful information. Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, Publication 519, *U.S. Tax Guide for Aliens*, Publication 901, *Tax Treaties*, and Publication 597, *Information on the United States—Canada Income*

<sup>49</sup> IR 2012-65, June 26, 2012, IRS announces effort to help US citizens overseas including dual citizens and those with foreign retirement accounts.

<sup>50</sup> 2012 WIRA Research Study 23-24.

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*Tax Treaty*, are available on IRS.gov and may also be available at U.S. consulates and U.S. embassies.

With respect to the recommendation to reinstate mailing forms and publications to international taxpayers and U.S. embassies and consulates, the process used for providing forms internationally is not substantially different than the process used in the United States for domestic taxpayers. The current International Program provides tax products to United States embassies, consulates, and various military legal assistance offices worldwide. Although forms are not mailed automatically, those entities can order bulk quantities of up to 81 different tax products that they need to provide the necessary level of service in those geographic areas. Each year, the various organizations are provided with a Form 14004, *International Program Order Form*, and Publication 4605, *International Program Quick Reference Guide*, which they use to order IRS tax products made available for U.S. citizens abroad to file their federal tax returns.

International taxpayers can also obtain products and information as outlined on IRS.gov at <http://www.irs.gov/uac/Contact-My-Local-Office-Internationally>.

**In-person Taxpayer Services at Four Foreign Posts Led by Tax Attachés.** Taxpayer assistance is provided in London, Paris, Frankfurt, and Beijing. In addition, outreach events are conducted by each Tax Attaché in his or her designated countries of jurisdiction to enhance taxpayer assistance and treaty partner relationships.

The duties of the Tax Attaché include the provision of taxpayer service involving U.S. citizens, non-resident aliens, and entities and the presentation of outreach events with the Department of State, practitioner communities, business organizations, and other federal, state, and local agencies.

**Free Return Preparation for U.S. Military Living Overseas.** To assist all military personnel living overseas, the IRS provides free tax assistance and return preparation at its Volunteer Income Tax Assistance sites. For FY 2012, IRS had 60 VITA sites located overseas at U.S. military bases where volunteers prepared approximately 40,180 returns through May 2012.

**Over the Phone Interpreter (OPI) Service and Pilot.** In 2009, the IRS implemented the Over the Phone Interpreter (OPI) Service at Taxpayer Assistance Centers throughout the United States. In 2011, the IRS piloted an OPI Service program for use at VITA/Tax Counseling for the Elderly (TCE) sites nationwide. This program allows IRS to serve taxpayers with limited English proficiency by providing foreign language translation services to partners and volunteers at VITA/TCE sites. This pilot expands existing OPI services previously only available for use by IRS employees. The service, offered at no cost to taxpayers or participating partners, allows our partners/volunteers to communicate with LEP taxpayers at their sites in over 170 foreign languages, thereby facilitating the return preparation process.

The FY12 OPI pilot was conducted January 17, 2012 through June 30, 2012, with 50 VITA/TCE sites participating nationwide (including Hawaii). Call volumes remained low throughout the pilot period; as a result, funding was reduced. Weekly status meetings continued with SPEC management to evaluate its usage and success. Since only 24 total responses were received, a management decision was made to discontinue the OPI pilot for the 2013 filing season.

**Foreign Language Websites.** In addition to recent improvements to IRS.gov, the IRS has two special websites available to taxpayers with limited English proficiency. The first, [www.irs.gov/Spanish](http://www.irs.gov/Spanish), includes access to many forms and publications in Spanish, including Publication 17, *El Impuesto Federal sobre los Ingresos* (Your Federal Income Tax). The second, [www.irs.gov/Individuals/Multilingual-Gateway](http://www.irs.gov/Individuals/Multilingual-Gateway), has information in Chinese, Korean, Vietnamese, and Russian. The IRS provides a DVD on basic tax responsibilities in five languages – Spanish, Chinese, Russian, Vietnamese, and Korean. This DVD is available at no charge.

The IRS will continue efforts to expand our strategic approach to international compliance by collaborating with TAS to address specific needs and compliance challenges of international taxpayers and coordinate international taxpayer service initiatives for all IRS functions.

## Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased with the IRS's commitment to improving taxpayer service to U.S. taxpayers who work, live, and conduct business abroad. We are also appreciative of the IRS's effort to coordinate international taxpayer service through the cross-functional International Individual Taxpayer Assistance team, in which TAS actively participates. The National Taxpayer Advocate strongly supports the team's efforts and believes that it has proven itself a vital tool in developing service channels for international taxpayers. The team's success depends on its adoption of a formal charter with clearly identified rights and responsibilities for all participants. The IRS cannot fairly evaluate the IITA's effectiveness without first identifying its mission, goals, and measures of performance in a formal charter.

The National Taxpayer Advocate commends the IRS for continued research on the filing behaviors, needs, and preferences of individual taxpayers living abroad, including the excellent 2012 WIRA research study. The study made a number of recommendations to improve service for international taxpayers, which TAS strongly supports. However, the National Taxpayer Advocate believes that the IRS cannot efficiently implement these steps without a systematic and structured plan available to the public. We look forward to working with the IRS on developing such a strategic blueprint for implementing the WIRA recommendations. We believe the IITA should develop a draft plan over the next six months and submit it to the IRS Services Committee for review and approval.

The National Taxpayer Advocate is pleased with the IRS's plans to significantly enhance IRS.gov and other online resources, including the rollout of international tax topics for the ITA application and availability of FFFF for use with foreign addresses beginning in 2013 (for TY 2012 returns). The IRS should continue to expand the availability of FFFF by making more forms and schedules fillable, particularly the new Form 8938, *Statement of Specified Foreign Financial Assets*, which if required must be filed with the tax return to comply with FATCA.<sup>51</sup> The National Taxpayer Advocate, however, is concerned about the lack of commitment to allow electronic filing of the 1040NR series of returns. The IRS should establish a timeline for implementation of Form(s) 1040NR and W-7 electronic filing and for resolution of security concerns for online chat and secure email.<sup>52</sup> The National Taxpayer Advocate also strongly supports the expansion of Virtual Assistance to taxpayers

<sup>51</sup> IRS, *List of Available Free File Fillable Forms*, available at <http://www.irs.gov/uac/List-of-Available-Free-File-Fillable-Forms> (last visited Dec. 18, 2012). The available forms include Form 1116, *Foreign Tax Credit*; Forms 2555 and 2555-EZ, *Foreign Earned Income Exclusion*; Form 8891, *U.S. Information Return for Beneficiary of Certain Canadian Registered Retirement Plans*; Form 8689, *Allocation of Individual Income Tax to the U.S. Virgin Islands*; and Form 8621, *Return by a Shareholder of a Passive Foreign Investment Co. or Qualified Electing Fund*. We note that although FBARs are not filed with the tax return, a link to the FBAR form on FFFF would also be helpful.

<sup>52</sup> However, it is unclear how the IRS is planning to accept electronically filed ITIN applications while continuing to require the concurrent filing of a paper tax return with the ITIN application. For a detailed discussion of ITIN issues, see Most Serious Problem: *The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Defer Fraud, infra/supra*.

abroad, and commits to work with the IRS to identify international sites for such service. These options are vital for alleviating compliance burdens faced by international taxpayers.

The National Taxpayer Advocate remains concerned about limited options available to “benign” U.S. taxpayers abroad who have not filed returns for various reasons and who have a *de minimus* tax liability. We believe the IRS should tailor its procedures for different groups of nonfilers and not employ a one-size-fits-all approach. Taxpayers who have not timely filed tax or information returns (*e.g.*, an FBAR) should not be herded into one “streamlined” program.<sup>53</sup> The National Taxpayer Advocate recommends establishing broad but clearly defined categories for different groups of international taxpayers, based on the country of residence, effective foreign tax rate, and AGI.<sup>54</sup> U.S. taxpayers abroad, including those who may have a liability exceeding the \$1,500 threshold, and especially those who did not file, should have easy self-correction options that combine simplified filing (or self-identification) with relief from all penalties if the taxpayer remains compliant for at least five years afterward. U.S. taxpayers abroad should also be able to file a simplified, combined tax and information return form online based on their income in a foreign jurisdiction, especially if the country has an effective income tax rate higher than that of the U.S. Given the complexity of U.S. international tax rules and the incompatibility of the U.S. worldwide system of taxation with that of most foreign countries that have territorial systems and value added tax, it is also reasonable to increase the current threshold for the “streamlined” filing from \$1,500 of tax due to \$5,000.<sup>55</sup> This approach will allow many international taxpayers to come into or return to compliance without draining IRS enforcement resources.

In regards to ordering international forms and publications online, the IRS.gov page does mention the Form 14004, *International Program Order Form*, and Publication 4605, *International Program Quick Reference Guide*.<sup>56</sup> However, the link offers only employer publications and information return forms, and does not contain forms and publications for international taxpayers. The IRS should make forms and publications available to taxpayers with no Internet access or low connection speed as well as at U.S. embassies and consulates. U.S. taxpayers abroad with limited or no Internet access rely on the availability

<sup>53</sup> IRS, *IRS Announces Effort to Help US Citizens Overseas Including Dual Citizens and Those With Foreign Retirement Accounts*, IR 2012-65 (June 26, 2012); see also IRS, *Instructions for New Streamlined Filing Compliance Procedures for Non-Resident, Non-Filer U.S. Taxpayers*, at <http://www.irs.gov/uac/Instructions-for-New-Streamlined-Filing-Compliance-Procedures-for-Non-Resident-Non-Filer-US-Taxpayers> (last visited on Dec. 5, 2012).

<sup>54</sup> For a detailed discussion of a three-category approach to improving the offshore voluntary disclosure programs to encourage voluntary compliance among those who failed to file FBARs and similar information returns, see Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*, *infra/supra*.

<sup>55</sup> See National Taxpayer Advocate FY 2013 Objectives Report to Congress 12-31. See also National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 35-73 ( Research Study: *An Analysis of Tax Administration Issues Raised by a Consumption Tax, Such as a National Sales Tax or Value Added Tax*). We have modified our recommendation here regarding the increased dollar limit to be consistent with our proposed limit in Most Serious Problem: *The IRS's Offshore Voluntary Disclosure Programs Discourage Voluntary Compliance by Those Who Inadvertently Failed to Report Foreign Accounts*, *infra/supra*, (recommending a cap of \$5,000 tax due for the Streamlined Non-Resident Filing Initiative, consistent with thresholds for application of an accuracy-related penalty under IRC § 6662(d).)

<sup>56</sup> IRS, *International Program Information*, available at <http://www.irs.gov/uac/International-Program-Information> (last visited on Dec. 5, 2012).

of IRS materials at U.S. diplomatic posts. It is also important that the website provide the necessary individual international forms and publications for online ordering from abroad.

Finally, the National Taxpayer Advocate urges the IRS to expand free preparation of returns for U.S. military personnel at 60 overseas locations to civilian U.S. citizens in those countries. It would require minimal resources but will significantly expand services for U.S. taxpayers abroad. We also encourage the IRS to expand Over the Phone Interpreter (OPI) service to overseas VITA sites and translate all of IRS.gov content into Spanish.

The National Taxpayer Advocate welcomes active collaboration between the IRS and TAS within the IITA team and elsewhere to address specific needs and compliance challenges of international taxpayers and to coordinate international taxpayer service initiatives.

## Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Make the IITA team permanent, with a formal charter and a responsibility to provide periodic written reports and formal recommendations to the IRS Services Committee, including items for the IRS Strategic Plan and Servicewide Approach to International Tax Administration.
2. Develop a systematic and structured plan for implementing the 2012 WIRA Research Study recommendations and informing the public about the timeline.
3. Reinstate mailing of forms and publications to international taxpayers who lack Internet access, and to U.S. embassies and consulates, and allow easy online ordering of international forms and publications through IRS.gov.
4. Accelerate electronic filing of 1040NR series returns and ITIN applications for non-resident alien taxpayers, at least for those not claiming a refund; and extend free file fillable ability to Form 8938.
5. Develop a method of simplified tax and information reporting online, modeled after the new online FBAR form for taxpayers incurring foreign taxes higher than the U.S. effective tax rate — resulting in no tax liability.
6. Establish a voluntary compliance program for individual international taxpayers, including a combination of simplified filing and relief from all penalties for nonfilers and taxpayers in countries with tax at rates higher than the U.S. effective tax rate
7. Increase the threshold for the Streamlined Nonresident Filing Initiative from \$1,500 of tax due to \$5,000.