DEMOCRATS ABROAD

Comment Regarding Notice of Proposed Rulemaking
Docket No. FINCEN-2021-0008 / 2021-27081

Policy Division
Financial Crimes Enforcement Network
P.O. Box 39
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Submitted online &
by *post*

Democrats Abroad is pleased to submit its comments regarding FinCEN's review of the Bank Secrecy Act Regulations and Guidelines, having approached this from a policy perspective and from the firsthand experiences of our 200,000 members. Our submission provides both a general response and answers to specific questions.

Since the passage of the Bank Secrecy Act in the 1970s, US citizens living abroad ("non-residents") have increasingly become caught up in ongoing efforts against tax evasion and malicious actors. While we recognize the importance of continued efforts, we believe that substantial adjustments to the Report of Foreign Bank and Financial Accounts (FBAR) are needed to ensure that the impact to ordinary law-abiding citizens is proportional to the financial law enforcement benefits.

Our specific recommendations, with rationale elaborated on in the responses to specific questions, are intended to help FinCEN achieve that proportionality while simultaneously improving FBAR's effectiveness as a law enforcement tool.

We advocate for:

- A one-time adjustment of FBAR reporting thresholds to $70,000, which accounts for inflation in the 50 years since FBAR's introduction, followed by annual inflation adjustments thereafter.
- Either:
    - An exemption of non-residents from reporting OR
    - A significantly higher reporting threshold for non-residents on the order of $400,000
- A partial repeal of FBAR reporting under the BSA, noting that it is highly redundant with both self-reporting provisions (IRS Form 8938) and automatically reported data (FATCA IGA data exchange). We note that this has been a recurring point of feedback from the IRS National Taxpayer Advocate for multiple years.[1] [2] [3] [4]

[1] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21_PurpleBook_02_ImproveFiling_8.pdf
[2] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_PurpleBook_02_ImproveFiling_9.pdf
[3] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/ARC19_PurpleBook_02_ImproveFiling_8.pdf
[4] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/07/ARC18_PurpleBook.pdf, Recommendation #12

- Improving the proportionality of enforcement/penalties for FBAR violations and clearly defining willful vs. non-willful recommendations. We note that this has also been a point of feedback from the IRS National Taxpayer Advocate.[5]
- Restoration of paper FBAR filings and improvement of e-Filing options to allow popular tax-filing software to include FBAR e-filing.
- Exclusion of accounts under a de minimis threshold, even when the reporting obligations are triggered based on aggregate foreign bank account balances.
- For non-residents, exclusion of accounts where a US Person only has signatory authority on the account but in which they have no beneficial interest.

At the present, FBAR reporting is redundant, disproportionate to risk, and it fails to take into account the necessities of holding foreign bank accounts when residing outside of the United States. At the same time, enforcement efforts are generally disproportionate, with FinCEN exercising little discretion and often pursuing statutory-maximum penalties even for infractions deemed non-willful. This results in highly, highly, regressive penalties that disproportionately harm the middle and working class.

Our proposals for reform are intended to reduce paperwork burdens for both the public and FinCEN, align reporting to accounts that are large enough to pose a substantial risk relating to financial crimes, and to ensure that enforcement serves a public benefit.

We thank you for the opportunity to provide commentary and recommendations, and we encourage you to read our responses to specific questions in the annex included with our letter.

Please contact Rebecca Lammers of our Taxation Task Force on taxadvocacy@democratsabroad.org with any questions about the information and recommendations provided.

Sincerely,

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[5] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_PurpleBook_04_ReformPenInts_35.pdf

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Annex: Responses to Specific Questions

Section: Safeguards to Protect the Financial System From Threats

Question 2: Do AML program requirements for financial institutions sufficiently address the threats, vulnerabilities, and risks faced by the U.S. financial system? If not, what changes do you recommend to ensure that AML program requirements adequately and effectively safeguard U.S. national security?

We encourage FinCEN to look inwards towards abuses happening within the U.S. financial system. While the Common Reporting Standard and FATCA have made it nearly impossible to obtain a financial account outside the United States without being subject to reporting and Know-Your-Customer (KYC) checks on both individuals and entities, the same cannot be said for financial services within the United States.

It has been publicly documented in a number of reports related to the "Pandora Papers" that substantial financial abuses now occur within the United States.[6,7,8,9]

Furthermore, close US trading partners have expressed condemnation of US non-reciprocity in tax cooperation agreements, further underscoring the US role in facilitating financial crimes.[10]

Excerpt from European Parliament Resolution P9_TA(2021)0392:

"47. Deplores the lack of reciprocity under the FATCA; observes that the United States is becoming a significant enabler of financial secrecy for non-US citizens; observes that there are two main loopholes: only information on US assets is shared, and no beneficial ownership information is shared; calls on the Commission and the Member States to enter into new negotiations with the United States in the OECD framework in order to achieve full reciprocity within a commonly agreed and strengthened CRS framework; stresses that this would lead to significant progress and lead to lower compliance costs for FIs and significantly reduce bureaucratic burdens; calls on the Commission and the Member States to enter into negotiations for a UN Tax Convention;"

[6] https://www.theguardian.com/news/2021/oct/04/pandora-papers-reveal-south-dakotas-role-as-367bn-tax-haven
[7] https://theconversation.com/the-pandora-papers-why-does-south-dakota-feature-so-heavily-169291
[8] https://www.washingtonpost.com/outlook/2021/10/07/south-dakota-pandora-papers/
[9] https://taxjustice.net/2021/10/08/pandora-papers-and-south-dakota-trusts-why-do-criminals-and-the-rich-like-them-so-much/
[10] https://www.europarl.europa.eu/doceo/document/TA-9-2021-0392_EN.pdf

Section: Reports and Records That Are Highly Useful in Countering Financial Crime
Question 3: Are there BSA reporting or recordkeeping requirements that you believe do not provide information that is highly useful in countering financial crimes? If so, what reports or records, and why? Conversely, are there reports Start Printed Page 71206 or records not currently required that would be highly useful? If so, what reports and records, and why?

Democrats Abroad believes that the usefulness of FBAR reporting is limited for four key reasons:

1. It is disproportionately filled with information concerning low-value accounts
2. Information reported is redundant with IRS 8938 forms
3. Information is redundant with data received under FATCA IGAs
4. Distinctions are not made between residents (where offshore accounts are *highly* unusual) & non-residents (who need to maintain local accounts in the countries where they reside).

Some of this is because reporting thresholds have not been indexed to inflation–what was once a sum of money that was atypical to have in bank accounts is now reasonably commonplace.

A greater portion of this issue is that the current regulations fail to distinguish between accounts *substantially contributing to the reporting threshold* and accounts that are *de-minimis*.

At the root of the problem however, is the lack of distinction between US Citizens whose non-US banking activity is normal due to their place of residence, and US Citizens whose non-US banking should be subject to additional scrutiny.

Section: Reports and Records That Are Highly Useful in Countering Financial Crime

Question 4: Are there specific changes to BSA reporting or recordkeeping requirements that would provide information that is more useful to law enforcement in countering financial crimes or allow financial institutions to better understand what information to report? If so, which reports or records, and what changes do you recommend?

As stated in the introduction to the Comment, Democrats Abroad has a number of concrete policy suggestions that will simultaneously increase FBAR efficacy while eliminating reporting that amounts to noisy data.

Question 7: Would automatically updating certain BSA reporting or recordkeeping requirements streamline or reduce the potential compliance burden without sacrificing the usefulness of the required BSA reports and records in countering financial crimes? If so, what other requirements might benefit from automatic updates? For example, should automatic updates to dollar thresholds for certain BSA reports and records occur to account for inflation adjustments? What other circumstances might necessitate automatic updates?

Our proposal to automatically index FBAR reporting thresholds to inflation and/or US currency valuations is a substantial streamlining of the regulation.

$10,000 in a bank account is not what it was in the 1970s, nor will our suggested $70,000 reporting threshold remain relevant on a forward-looking basis.

We also note that currency exchange rate fluctuations can also have a substantial impact on reportable balances, which should be taken into account.

Question 8: Should FinCEN consider periodic adjustments, such as customized thresholds, to BSA regulations and guidance to account for changes in risk, such as changes in geographic risk? What circumstances might necessitate customized thresholds and why?

We believe that thresholds should be customized to take into account "Geographic Risk". The motivations and justifications for non-US accounts differ greatly between resident and non-resident US citizens.

Furthermore, customized thresholds should be applied to certain types of highly regulated accounts such as retirement accounts. These accounts are almost always non-portable and cannot be "onshored" to the United States, even if someone returns to the United States and is physically resident there.

Such customized thresholds by account category would require clear communication strategies to ensure a proper understanding of what accounts are and are not reportable.

Section: Identify BSA Regulations and Guidance That May Be Outdated, Redundant, or Do Not Promote a Risk-Based AML/CFT Regime for Financial Institutions

Question 9: Are there BSA regulations or guidance that do not promote risk-based safeguards or that no longer fulfill their original purpose? If so, which regulations or guidance, and what changes do you recommend?

The FBAR regulations and guidance as a whole do not promote risk-based safeguards, and arguably do not fulfill their original purpose. We substantiate this with:

- FBAR thresholds are low, lack a concept of de-minimis reporting on an account-by-account basis, and have not been indexed to inflation
- FBAR filing obligations do not differentiate between purposes of accounts, nor do they take into account the special situation of US citizens residing abroad who are obliged to maintain local bank accounts to make everyday payments.
- Steep penalties for non-willful reporting violations and a lack of discretion exercised by FinCEN in pursuing maximum versus non-maximum penalties indicate that FBAR reporting is no longer serving as an effective tool against financial crimes, but a

highly regressive tax on often middle-class individuals who were (by non-willful definition) unaware of their mistakes.

Question 10: Are there BSA regulations or guidance that are obsolete or no longer provide useful information to the government? Alternatively, are there any BSA regulations or guidance that target risks that no longer exists? If so, which regulations or guidance, and what changes do you recommend?

Democrats Abroad believes that the FBAR has become obsolete due to the introduction of other overlapping data reporting mechanisms, both in the form of the IRS 8938 form and the automatic data exchanges facilitated by the FATCA IGAs.

At the time of its introduction in the 1970s, automatic reporting was not yet a concept, nor was international tax cooperation in the advanced state that exists today.

An examination of the duplication in reporting and a harmonization of approaches is strongly encouraged by us, as it has been by the IRS National Taxpayer Advocate for a number of years.

If the Treasury were to pick between elimination of FBAR and Form 8938 reporting, we strongly believe that the FBAR should be eliminated, as it cannot be e-Filed like IRS forms can. Furthermore, public awareness of it is generally lower than awareness of annual tax filing obligations.

Where possible, FATCA IGA reporting should be leveraged to avoid unnecessary self-reporting. This is likely to remain viable even if FATCA were to be replaced by a standard such as the Common Reporting Standard. We also note that there are compelling arguments for Treasury to repeal FATCA and adopt the CRS due to its inclusion of data that is presently-exempt from FATCA IGA reporting.

Question 11: Are there any BSA regulations or guidance that are obsolete because of changes in compliance business practices and/or technological innovation in the financial system or elsewhere? If so, how should FinCEN address this?

We refer to our response to Question 10. Automatic exchange of information under FATCA and/or CRS renders self-reporting redundant and obsolete.

Question 12: Do FinCEN's regulations and guidance sufficiently allow financial institutions to incorporate innovative and technological approaches to BSA compliance? If not, how can FinCEN facilitate greater use of these tools, while ensuring that appropriate safeguards are in place and highly useful information continues to be reported to government authorities?

We believe that this question speaks to a common misconception that only financial institutions, companies, or high-net-worth individuals have an international presence and are affected by changes to regulations at FinCEN or the IRS.

There is a substantial body of evidence from non-government research and IRS filing data that demonstrates a large working and middle-class impact from BSA regulations.

If any changes are to be made in relation to FBAR regulations and guidance, they must be:

1. Plain language
2. Highly multilingual
3. Well communicated
4. Accessible to ordinary individuals, rather than tax preparers or compliance experts

With regards to the question as it was posed: The present FBAR filing system is a barrier to technological compliance approaches, requiring a specific piece of proprietary software (Adobe Acrobat) and offering zero possibility to integrate into existing e-filing workflows common in the tax preparation space.

Question 14: Are there BSA regulations that impose requirements that are identical to or significantly overlap with requirements imposed under another regulatory regime? If so, which BSA regulations, and which other regulatory framework?

Democrats Abroad believes that FBAR Reporting is highly redundant with regards to both FATCA IGA and IRS 8938 reporting.

While neither reporting regime is a BSA regulation, both are under the purview of the Treasury and have been specifically recommended for harmonization and consolidation.

Question 16: Do any BSA regulations or guidance require or encourage resources be allocated inefficiently based on the level of risk that the regulations or guidance are intended to prevent or mitigate? If so, which regulations or guidance, and what changes would you recommend FinCEN make?

As stated in our general feedback and in our responses to other questions, the present reporting rules for FBAR result in inefficient resource allocation and are generally not risk-aware.

The three specific issues in this area:

1. The $10,000 reporting threshold has not been indexed to inflation and is low enough that everyday banking activity results in a report.
2. When the aggregate reporting threshold is reached, even de-minimis accounts are reported.
3. Reporting of accounts where there is signatory authority but no beneficial interest often results in the inclusion of accounts that are unlikely to be of relevance.

Question 18: How else can FinCEN reaffirm that BSA regulations and guidance are intended to foster a risk-based approach?

We believe that FinCEN should adopt a risk-based approach with regards to its penalties and enforcement relating to FBAR.

Much of our response would duplicate the findings in 2020 NTA Recommendation #35[11], which we encourage to be read in addition to our comment.

The current approach taken by FinCEN:

- Is overall disproportionate to many reporting failures
- Sets a low and ambiguous bar for willful vs. non-willful violations
- Applies deeply excessive civil penalties *far* exceeding any others in the United States.

Though statutes authorize high penalties, significant discretion should be exercised to take into account the financial means of the taxpayer and whether or not the individual is compliant with tax obligations.

FBAR enforcement should serve as a deterrence to non-reporting, rather than acting as a revenue driver. It should also be noted that the fear of excessive penalties is often discussed as a barrier to non-filers entering into the US tax system and becoming compliant.

We also note that the world has changed significantly since the 1970s, when internet banking and online payments were not yet envisioned. Inadequate communication from FinCEN / Treasury and outdated regulations have the potential to generate non-wilful violations at a massive level. This is aggravated by increased regulation in foreign financial markets, where more and more everyday services have a "bank" account attached to them, even when this is not apparent to all customers.

[11] https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_PurpleBook_04_ReformPenInts_35.pdf

Question 21: Do any BSA regulations or guidance fail to conform with U.S. commitments to meet international standards, or do not fully implement international standards, including the FATF Recommendations? If so, which regulations or guidance, and why?

While not falling fully within the BSA wheelhouse, general US non-reciprocity and facilitation of financial crimes has been a concern raised by the international community.

We also note that excesses in enforcement may pose challenges to cooperation with other governments and collection of penalties.

See Question #2 for additional context.

Section: Identify BSA Regulations and Guidance That Do Not Conform With International Standards To Combat Financial Crime

Question 23: Are there BSA regulations or guidance that should be amended to improve their efficiency? If so, which regulations or guidance, and what amendments do you recommend?

We believe that modernized e-filing for FBAR and elimination of self-reporting in situations where similar data is automatically reported are the two most substantive efficiency improvements.

Modern e-filing should permit common tax preparation software suites to prepare and file FBAR reports, ideally via APIs that avoid the need for human reading or transcription.

We also note our previous recommendations around inflation indexing, exclusion of de-minimis accounts, and assessing risk based on residency(including the exclusion from FBAR reporting of accounts held by a foreign-resident US taxpayer in his country of foreign residence, taking into account, inter alia, that no similar reporting obligation is currently imposed on US-resident US taxpayers with respect to accounts held within the US).

Question 24: Are there BSA regulations or guidance that are unclear or are overly burdensome in comparison to the risk posed? If so, which regulations or guidance? To what do you attribute the additional burden, and in what way (if any) is the burden excessive compared to the benefits of the regulation? Could the burden be reduced without making the regulations or guidance less effective? If so, how?

We believe that the FBAR reporting regime is overly burdensome in comparison to the risk posed. This burden is attributable to:

- Non-risk based reporting
- Redundant reporting
- Excesses in enforcement

While the FBAR reporting burden itself is relatively insubstantial, lack of clarity around reporting obligations and severe penalties result in this being a form commonly outsourced to professional tax preparers.

This is, in many ways, a $150 "tax" on working and middle class people who are uncomfortable preparing and submitting a simple form backed by draconian penalties.

We also note that the severity of penalties may not serve as an effective deterrent against non-reporting. Fear of disproportionate penalisation sometimes promotes an image of "lose-lose" in which someone faces equally unaffordable penalties *either* from non-filing or from innocent mistakes. This does not encourage tax or information reporting compliance.

Question 25: Aside from any regulations or guidance identified in response to previous questions, are there any BSA regulations or guidance with which you believe compliance provides minimal or no benefit to the government, thus making any compliance burden excessive? If so, which regulations or Start Printed Page 71207 guidance, and would you propose to amend or repeal them? If amend, how? And if repeal, why repeal rather than amend?

We strongly support a repeal of FBAR regulations, which are detrimental to the public and appear to provide minimal benefit to the government.

Such a repeal is *certainly* appropriate for non-residents due to alternative and redundant reporting mechanisms, and it is *arguably* appropriate for US residents as well.

Recognising that Treasury may disagree with a full or partial repeal, we stand by our recommendations for amendments to the FBAR reporting regime.

We also note the existence of foreign Ultimate Beneficial Owner (UBO) registers and Anti-Money-Laundering (AML) procedures that are often-times stronger and more systematic than any imposed by FinCEN and the BSA regulations. Any evaluations of redundancy should include jurisdictions with comparable regulations and who are cooperative in tax matters.

26. In what ways could BSA regulations or guidance be more efficient in light of innovative approaches and new technologies. For should any BSA regulations or guidance account for technological advancements, such as digital identification, machine learning, and artificial intelligence? If so, how?

We advise FinCEN to exercise extreme caution with its use of technology to improve efficiency in processing reports. Use of such systems may be appropriate in highlighting reports to audit, but we advocate for humans to make the ultimate decision to assess penalties. Technology provides a means to assess information, but such assessments are fallible and should not be regarded as evidence on their own.

Many of our members have played witness to a growing number of international scandals centered around the use of software intended to improve enforcement efficiency, but with unacceptably high false-positive rates and inadequate opportunities for manual review or redress. Some of these scandals have been included in US Congressional testimony as examples of what *not* to do.

Two of the most prominent examples are the Dutch *Toeslagenaffaire* ("Child Benefits Affair") and the United Kingdom's "Horizon" Post-Office Scandal. The fallout of the Child Benefits Affair resulted in the resignation of the entire Dutch government cabinet[12] and the UK Horizon scandal is publicly documented to have resulted in suicides by the unjustly accused[13] and jail sentences for innocent people[14].

We also note that United States tax and financial regulations are *highly* extraterritorial in nature and possibly in conflict with foreign laws and due process protections. Given that the European Union's General Data Protection Regulation (GDPR) has specific and additional safeguards that apply in any sort of automated decision making, we urge extreme caution.

Automated enforcement efforts may introduce valid appeals to legal compatibility, rights, and due process with regards to countries that assist the US. We note that many EU courts have taken dim views towards algorithmic tax/law enforcement due to recent missteps.

We urge FinCEN to be mindful of EU court rulings (*Schrems, Schrems II)* that conclude that the United States has inadequate due process protections and oversight. It is reasonable to question whether "algorithmically assessed FBAR penalties" would be specifically excluded from mutual collection assistance.

[12] https://www.theguardian.com/world/2021/jan/15/dutch-government-resigns-over-child-benefits-scandal
[13] https://www.independent.co.uk/voices/post-office-scandal-high-court-ruling-subpostmaster-a9253236.html
[14] https://www.theverge.com/2021/4/23/22399721/uk-post-office-software-bug-criminal-convictions-overturned