ABSTRACT

Tax reform is a topic that is could be described like the weather– Everybody talks about it, but nobody does anything about it. While tax reform may be desirable, when it comes down to specific proposals there is frequently a push-back as groups and individuals lobby to protect their self-interests. One area of tax reform that is of great importance is that of a territorial versus a worldwide taxation system. While this distinction may be lost on the average taxpayer, the implications of reform in this area have multiple implications. This paper discusses the two systems and three areas of tax law that have significant impact on U. S. taxpayers – the foreign tax credit, the foreign earned income credit/exclusion, and the reporting of foreign bank accounts.

Worldwide and Territorial Tax Systems

The United States has a worldwide tax system. This simply means that a U. S. person will be taxed on his or her worldwide income, regardless of source. U. S. persons are defined as U. S. citizens or residents as well as domestic partnerships, corporations, estates, or trusts. Worldwide tax systems create compliance nightmares. The IRS has not developed an estimate of the international tax gap, but others estimate this amount to be between 40 and 123 billion dollars per year [10]. By its nature, the true amount cannot be known. Efforts such as the Foreign Account Tax Compliance Act (FATCA) are designed to discover foreign assets of U. S. citizens. In addition, the Bank Secrecy Act requires an annual report of foreign bank accounts. This report is made by filing Form TD 90-22.1 with the Department of Treasury, listing foreign bank accounts over which the taxpayer has authority. This is commonly known as FBAR (Report of Foreign Bank and Financial Accounts).

The U. S. system allows tax liabilities on foreign income to be deferred until it is “repatriated” or returned to the United States. This is seen as critical to stability of the U. S. international tax system as it provides a “near-level playing field with companies domiciled in nations with more favorable tax climates [3]. This has resulted, however, in an estimated 1.7 trillion dollars in earnings being held in foreign nations in order to avoid U. S. taxation on those earnings.

In contrast to a worldwide tax system, nations may adopt a territorial tax system. Under a territorial system, a country collects tax only on income earned within its borders. A common feature in such systems exempts dividends from foreign subsidiaries from the domestic tax base [3].

The United States is the only major industrialized nation with a worldwide tax system and a statutory income tax rate in excess of 30 percent [4]. In recent years there has been a movement away from worldwide systems to territorial systems. In 2000, worldwide systems represented 66 percent of
total GDP amount Organisation for Economic Co-operation and Development (OECD) nations. In 2012, that percentage dropped to 45 but is heavily weighted by the United States. Twenty-seven of the 34 OECD nations now employ some type of territoriality [3].

There are four observations that should be made regarding the current U. S. worldwide system. First, U. S. taxpayers are allowed a credit for taxes paid to foreign governments. However, this offers little relief, as the U. S. corporate rate so high compared to other nations and the individual rate is typically higher.

Second, worldwide taxation of corporate income accounts for a large share of tax compliance costs. Adoption of a territorial system would result in significant simplification and reduction of compliance costs. This would also be true on a lesser level for individual taxpayers.

Third, territorial taxation is based on the concept that governments should tax only the income earned within its borders. To those growing up with the U. S. worldwide system, this sounds somewhat heretical, but worldwide systems create trade barriers and are in opposition to free-market tax policies.

Fourth, if the U. S. moved to a territorial system, the competitiveness of U. S. companies would receive a significant boost and U. S. exports would surge.

Dittmer did a study of nations that have moved from a worldwide system to a territorial system since 2000. Among these nations were Japan, the United Kingdom, Canada, Germany, and The Netherlands. Japan and the UK are particularly relevant, as their worldwide system closely resembled the current U. S. system. There were a number of fears that the new system would create unemployment, a decline in wages, and a decrease in corporate tax revenues. None of these happened as unemployment declined, wages increased, and corporate tax revenues remained stable. In addition, these nations experienced fewer distortions in corporate behavior [3].

What is involved with a move toward a territorial tax system? Currently, U. S. laws utilize the “arms-length” method in allocating costs and revenues among its various corporate structures. The arms-length method operates under the condition that the parties to a transaction are independent and on an equal footing. [12]. This assumption is difficult to maintain in practice. On an international level, it requires multinational enterprises that have a permanent establishment within a country to calculate their profits as if their integrated operations were separate and distinct from each other. Every internal transfer of goods and services occurs under the assumption that transfers occur as if with an unrelated party at market prices. This allows income shifting to low-tax nations and expense shifting to high tax countries [11]. In addition, the arms-length approach relies on the income reported in a particular country. This ignores the realities that a company’s presence in a nation goes beyond reported income. It basically requires a company to price each internal transaction across countries.

**FORMULARY APPORTIONMENT**

What is needed in transferring to a territorial tax system is a system of formulary apportionment (FA). This approach makes the tax liability of a taxpayer dependent upon its business activity in a country, rather than the income reported. Formulary apportionment allocates the profit earned, or loss incurred, by company to a particular tax jurisdiction through consideration of a number of factors.
Advocates of FA promote the simplicity, flexibility, stability, and competiveness of such a system. In reality, such a system is somewhat in place in regard to taxation in the U. S. across state lines.

It is simple. A company knows how much it earned in each nation by multiplying its total profits by the share of its business activity in each nation. There is some debate on how business activity is measured, but it generally is a matter of the weights assigned to the various relevant activities.

It is flexible. It treats a complex multinational organization as a single economic entity for tax purposes. Economic substance rather than legal form takes precedence.

It enhances stability. As long as a company shows overall profitability, each nation is guaranteed a positive tax base unlike the current situation under which profitability can make wide swings from year to year. This reduces uncertainty for the enterprise as well as the tax authorities.

It promotes competitiveness. Each nation designs its tax structure to encourage companies to locate factories and employees in the nation. This is as opposed to focusing on just income in the nation. [11].

The factors to be incorporated into FA are a matter of debate, as well as the weighting of each factor. However, the European Union has drafted a formulary apportionment system for member nations. The formula is based upon four factors. One-third is based on property in the nation, one-third on sales, one-sixth on number of employees, and one-sixth on employee compensation. Adherents admit that this, or any FA formula, is not perfect. It is, however, seen as superior to the arms-length method. FA does close the tax gap through restrictions on income shifting. Problems arise with how to deal with intangible assets and in determining what members belong in the consolidated group. However, these issues are not unique to FA and should not be a deterrent to its adoption [11].

**FIVE REASONS TO ADOPT A TERRITORIAL SYSTEM**

Any number of reasons has been given for the U. S. to move to a territorial system but five of them stand out as compelling [5].

1. As the United States is immersed in an increasingly dominant international environment it is imperative that the U. S. tax system be aligned with its global trading partners. Companies no long need a U. S. presence in order to compete in the U. S. market, as trade and consumerism have become internationally mobile.

2. One of the basic principles of taxation is the benefit principle, which states that taxes should be based on the benefits received by entities using the goods financed with the tax. The worldwide tax system violates this principle by taxing profits earned in another tax jurisdiction. A territorial system is more closely aligned with the benefit principle.

3. Even though the United States is said to operate under a worldwide system, the truth is that it has a dual system. Foreign-owned companies are taxed territorially; that is, they pay tax in the United States based upon income that is “effectively connected” to the U. S. This dual system puts U. S. companies at a disadvantage in attempting to acquire foreign businesses or assets due to the higher after-tax returns that must be earned by a U. S. company as compared to a company operating under a territorial system.
4. The compliance cost of a worldwide system is extremely high. One study showed that over 40 billion dollars is spent annually by U. S. companies to comply with the U.S. tax code. At least 40 percent of this amount is due to the international provisions in the code. European firms under territorial systems do not report a disparity between complying with domestic and international rules [2].

5. The current worldwide system in the United States “traps” capital abroad. Since foreign earnings are not taxed until “repatriated” or brought back into the U. S., these earnings remain in various foreign nations to avoid paying U. S. tax on these profits. It has been estimate that over 1.7 trillion dollars have been kept out of the U. S. for this reason [13].

**WORLDWIDE SYSTEMS AND THE INDIVIDUAL**

Although much of the discussion of a worldwide versus a territorial tax system has focused on companies, the U. S. worldwide system can have a significant impact on individuals. This is seen in three areas of our tax law:

1. The foreign tax credit, which utilizes Form 1116
2. The foreign earned income exclusion/credit using Form 2555

**FOREIGN TAX CREDIT**

Form 1116 is utilized to take a credit for foreign income taxes paid. It most frequently arises with the receipt of dividends and interest from foreign sources, although it may apply in other cases. Taxpayers may elect to claim the credit without filing Form 1116 if three conditions are met:

1. All foreign source gross income was “passive category income” which includes most interest and dividends.
2. All of the income and any foreign taxes paid were reported on a qualified payee statement such as a 1099 or Schedule K-1.
3. The total of creditable foreign taxes does not exceed $300 ($600 married filing joint) [8]

Even though this is a rather generous exclusion that excludes many taxpayers from filing Form 1116, it still results in additional time involved in the preparation of the return. The credit is a dollar-for-dollar credit but the income is still fully taxable in the United States and usually results in additional taxes being paid due to higher rates in the U. S. Form 1116 applies to individuals, estates, and trusts. Corporations must file Form 1118, which is an eight-page form with a higher level of complexity.

**FOREIGN EARNED INCOME EXCLUSION**

United States citizens and green card holders are subject to tax on their worldwide income, regardless of source. Therefore, a citizen or resident working in a foreign country is subject to United States income tax on his or her earnings in that foreign country. This is a consequence of the U. S. worldwide taxation scheme. Frequently those earnings are also subject to tax in the host country where the money is earned. In order to lessen the burden of double taxation, U. S. income tax law provides for a Foreign Earned Income Credit or Exclusion. This allows qualifying taxpayers to avoid tax on up to
$97,600 of foreign income in 2013. The amount of the exclusion is indexed for inflation and changes annually. In addition, the exclusion is per individual, so a married couple each can exclude up to the maximum amount each year. In addition, there is a foreign housing exclusion that is also available.

As mentioned, this may be utilized as an exclusion or as a credit. If the tax in the host country is higher than the U. S. rate, the credit would be most beneficial. Otherwise, the exclusion should be taken, as is most often the case. In addition, if the host country does not have an income tax or does not subject the earnings to its tax regime, the exclusion is still allowed.

There are three requirements to qualify for the credit. The taxpayer’s tax home must be in a foreign country, the taxpayer must have foreign earned income, and the taxpayer must meet the bona fide residence or physical presence tests.

**Tax Home**

First, the tax home must be in a foreign country. The IRS defines a tax home as “the general area of your main place of business, employment, or post of duty, regardless of where you maintain your family home”[6]. A foreign country does not include the Antarctic or U. S. possessions such as American Samoa, Guam the U. S. Virgin Islands, or Puerto Rico.

**Foreign Earned Income**

Second, there must be foreign earned income. Foreign earned income is income in the form of wages, salaries, commissions, bonuses, professional fees, and tips. Self-employment income can also be foreign earned income. It does not include pensions, income received as a military or civilian employee of the U. S. government, income from services performed in international waters, or income for services in specified combat zones. In addition, dividends, interest, capital gains, gambling winnings, and alimony are not earned income.

The source of the earned income is the place where the individual performed the services for which compensation was received. These funds can come from a U.S. or a foreign organization. For example, assume that an employer is located in Orlando, FL and earnings are deposited into a taxpayer’s bank account in a bank located in Memphis, TN. The income was earned while working in Ghana. This is foreign earned income.

The foreign earned income exclusion does not apply to social security, Medicare, or self-employment taxes. In addition, the taxpayer must file a return in order to take the exclusion even if there is no tax liability.

**Bona Fide Residence or Physical Presence**

The taxpayer must meet either the bona fide residence test or the physical presence test in order to qualify for the exclusion or credit. The bona fide residence test is met if the taxpayer is a bona fide resident of a foreign country for an uninterrupted period that includes an entire tax year. To be considered a bona fide resident, the taxpayer must have established a bona fide residence in the country. This is determined on a case-by-case basis, but generally the taxpayer must be able to prove that he/she is
living as a resident of a foreign country, paying any local income taxes and living as a citizen of the local economy. The intent is that the taxpayer plans to reside in that country indefinitely.

The physical presence test is met if the taxpayer is physically present in a foreign country or countries for 330 days during a period of 12 consecutive months. It does not require that the days be in one tax year. If the taxpayer is not physically present for the entire tax year, the amount of the exclusion will be pro-rated. For example, if a taxpayer arrived in a foreign country on August 2, 2012, he or she would meet the 330 day requirement on June 28, 2013, assuming they did not return to the U. S. for business during that time. For 2012, the taxpayer would have been physically present in a foreign country for 151 days. The exclusion amount would be 151/365 X $95,100 = $39,343. Since the 330-day test was not met until June 28, the taxpayer should file for an extension and file the return once the test is met. Alternatively, a timely filing can be made and an amended return filed when the test is met.

Once the test has been met, the taxpayer continues to be qualified until returning to the U. S. for more than 35 days in a 12-month period. To take the above example one step further, assume that the taxpayer remained in the foreign country all of 2013. He or she would qualify for the full amount of the exclusion. Further assume that, in 2014, the taxpayer returned to the U. S. for 30 days in January, then returned to the foreign country. The qualification continues as the taxpayer maintained a foreign tax home.

The rules do not require employment during the entire time, nor does it require working or remaining in the same country in order to qualify. For example, assume that the taxpayer’s assignment ended and he or she has only been in a foreign country for 315 days. The taxpayer could remain in a foreign country for an additional 15 days and meet the physical presence test, but would not need to be employed during that time.

The only exception to the 330-day test is that if the taxpayer must leave the country because of war, civil unrest, or adverse conditions in that country. The IRS publishes an annual list of countries that qualify for the waiver. You should be able to prove that you would have met the time requirements if adverse conditions had not prevented your stay.

*Taking the Exclusion or Credit*

The exclusion or credit is taken by filing Form 2555 or 2555-EZ. If choosing the exclusion, the taxpayer cannot subsequently take the credit in another tax year unless he or she attaches a statement indicating that the choice of the exclusion is being revoked.

When excluding income under the foreign earned income exclusion, any remaining taxable income will be taxed at the rate it would have been subject to if the exclusion were not taken. For example, assume a filing status of married filing jointly with taxable income in 2013 of $110,000 without regard to the exclusion. If the taxpayer qualifies for the full exclusion, that reduces taxable income to $12,400. This amount of taxable income would normally be subject to a 10 per cent rate. However, lacking the exclusion, the taxpayer would be in the 25% bracket, so the $12,400 would be taxed at 25%.
**Withholding**

In many instances, the salary received by a taxpayer will allow the taxpayer to totally avoid withholding on his or her salary. If this is the case, the taxpayer can file a Form 673 with the employer. This form will instruct the employer to discontinue withholding for U. S. income tax from that employee. However, the IRS guidelines state that if the employer has reason to believe that the employee will not qualify for the exclusion, Form 673 may be disregarded.

There is one caution in regard to withholding. If the employee does not file a Form 673 but qualifies for the exclusion, there may be a situation in which the employee’s withholding exceeds his or her adjusted gross income. When this occurs, the return cannot be submitted via e-file.

**Foreign Housing Exclusion or Deduction**

In addition to the foreign earned income credit or exclusion, qualified individuals may take an exclusion or deduction for foreign housing costs. The amount of the deduction is determined as follows (using 2013 amounts):

\[
\begin{align*}
\text{\$97,600 x 30\%} & \quad \text{\$29,280} \\
\text{Minus: 97,600 x 16\%} & \quad \text{15,616} \\
\text{Maximum Housing Exclusion} & \quad \text{13,664}
\end{align*}
\]

The $97,600 is the maximum foreign earned income exclusion; the 30% of the exclusion amount is the statutory limitation or maximum. This maximum applies unless the taxpayer is in a location having a higher maximum exclusion. This list is found in the Instructions for Form 2555. Sixteen percent represents the base housing amount. This maximum exclusion would be subtracted from actual housing expenses to determine the amount that may be excluded.

Housing expenses include reasonable expenses incurred or paid in a foreign country for housing and include only the portion of the year in which the taxpayer qualifies for the foreign earned income exclusion. Housing expenses include employer-provided amounts either paid to the individual or paid by the employer to third parties.

The foreign housing exclusion is chosen by completing the appropriate sections of Form 2555. The foreign housing deduction is limited to those with self-employment income and may be deducted on line 36 of Form 1040.

**Complexity**

Obviously, this is not an easy section of the Internal Revenue Code to navigate. Few individuals understand the intricacies of this law. Unfortunately, there are a significant number of tax preparers who do not understand it either. When a practitioner is known to be knowledgeable in this area of tax law, it is not uncommon to receive communication from U. S. taxpayers worldwide.

If the United States were to adopt a territorial tax system, all of the problems associated with the foreign earned income exclusion/credit would disappear and the tax code would tax a step toward
simplicity. The income would simply not be taxable in the United States, regardless of how much the taxpayer earned or how long the taxpayer was physically present in a foreign country.

FOREIGN BANK ACCOUNTS

Those having an interest in a foreign bank account may be subject to reporting requirements. There are two pieces of legislation that relate to these accounts. The Bank Secrecy Act requires that certain financial accounts based in foreign countries be reported to the Department of Treasury. This act has been in place for a number of years and is commonly known as FBAR (Report of Foreign Bank and Financial Accounts). The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 with the intent of identifying American account holders in foreign bank and requiring payment of taxes on income from these investments. These rules apply to individuals as well as business organizations.

FOREIGN BANK ACCOUNT REPORTING

Under FBAR, anyone with a financial interest or signature authority over a foreign financial account may be required to file Form TD F 90-22.1 with the Department of Treasury. Note that this is not an income tax form, and is not filed with the IRS. The due date for the return is June 30 of the year following the calendar year being reported. This is known as the Report of Foreign Bank and Financial Accounts and does not require the payment of taxes. It is merely informational with the intent of identifying offshore financial assets owned by U. S. taxpayers.

Financial Accounts

A foreign financial account includes any savings or checking deposit in an account maintained with a foreign financial institution. This includes savings and checking accounts in addition to any account in which the account has an equity interest in the fund, such as a mutual fund. It does not include ownership of individual bonds, notes, or stock certificates held by the owner. A foreign country is defined for this purpose as all geographical areas outside the United States, the commonwealth of Puerto Rico, the commonwealth of the Northern Mariana Islands, and the territories and possessions of the United States.

Who Must File

There are two basic filing requirements for those having a foreign financial account. First, this applies to “United States persons.” A United States person includes a citizen or resident of the United States, a domestic partnership, a domestic corporation, and a domestic estate or trust. United States persons must also have “signature or other authority over an account.” This means the authority to control the disposition of money by signing a check or similar document. Authority also exists if the person can exercise that power through direct communication with the financial institution.

The second requirement is that the account must be reported if the aggregate value of foreign financial accounts in which there is a financial interest exceeds $10,000 at any time during the calendar year. This requirement has a couple of provisions that can be easily overlooked. First, the accounts are reportable if the value exceeds $10,000 at any time during the year. Not the average balance for the year. For example, if $12,000 were deposited into an account one morning, then withdrawn the following day, a reporting requirement would be triggered, as the value of the account exceed $10,000. Secondly, the reporting requirement is for the aggregate value of all foreign financial accounts. Thus if there were two accounts, and the value of those combined accounts exceeded $10,000 at any time, the reporting requirement is triggered.
Reporting Issues and Penalties

As mentioned, the FBAR is not an IRS form and is sent to the Department of Treasury. The report is due June 30 and cannot be extended. In addition to the FBAR requirement, all foreign accounts should be reported to the IRS. For individuals filing a 1040, a response to Schedule B, Part III, lines 7a or b is required if the taxpayer is reporting over $1,500 of taxable interest or ordinary dividends or had a foreign account. In addition, if there was a distribution from a foreign trust or the taxpayer was a transferor or grantor of such a trust, lines 7 a or b must be answered in a positive manner. Schedule B of the 1041, 1065, and 1120 have similar requirements. If required to check “yes” on any of these boxes, a failure to do so is interpreted as a willful failure to file if a TD F 90-22.1 is required. The Schedule B reporting is limited to the existence of the accounts. These accounts must be reported in detail on the TD F 90-22.1 if the form is required to be filed.

Although there is no tax associated with TD F 90-22.1, there are significant penalties for not filing the return. These penalties can be civil or criminal. A willful failure to file may carry a criminal penalty of up to $250,000 and/or up to five years in prison. Each missing FBAR is a separate crime. A civil willful failure to file carries a penalty of up to $100,000 or 50% of the highest balance in each unreported account for the year. If it can be demonstrated that the failure to file was not willful, the penalty would be much lower, frequently $10,000.

There are three important points about the penalties.

1. Penalties are assessed per account, not per return.
2. Penalties apply for each year of each violation.
3. Penalties can apply to each person with a financial or signature authority over the account.

It is readily apparent that the penalties can escalate quickly and can substantially exceed the balance in the foreign accounts.

FOREIGN ACCOUNT TAX COMPLIANCE ACT

The Foreign Account Tax Compliance Act (FATCA) was enacted in order to combat U. S. tax evasion by taxpayers holding investments in foreign accounts. This is somewhat controversial, as it raises privacy issues, especially for those having dual citizenship. Also, a number of European banks and financial institutions have been closing brokerage accounts for all U. S. customers due to perceived “onerous” U. S. regulations [1]. There are three components to the Act. The original effective date was January 1, 2014, but the IRS has delayed implementation. Institutions now have until January 1, 2017, to begin withholding U. S. tax from clients’ investment gains. However, procedures to meet FATCA reporting requirements must be in place by January 1, 2014.

The first section requires foreign financial institutions (FFI) to undertake certain identification and due diligence procedures in an effort to discover any U. S. account holders. U. S. account holders are defined as U. S. persons or foreign entities with substantial U. S. ownership. For any accounts that have been so identified, the FFI is to report annually to the IRS the balances, receipts, and withdrawals from these accounts. The IRS is empowered to require participating FFI’s to withhold and pay to the IRS 30 percent of any payments of U. S.-source income made to non-participating FFI’s, individual account holders who have not provided sufficient information to determine if they are a U. S. person, and foreign entity account holders failing to provide sufficient information about the identity of its substantial U. S. owners. [1]
The second section focuses on the individual accountholders themselves. It requires disclosure of foreign assets by filing Form 8938 with the annual 1040. Threshold amounts for filing the form depend on filing status and residency.

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Living in the U. S.</th>
<th>Not Living in the U. S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single or Married filing separate</td>
<td>Balance of $50,000 on last day of year or $75,000 at any time during the year.</td>
<td>Balance of $200,000 on last day of year or $300,000 at any time during the year.</td>
</tr>
<tr>
<td>Married filing jointly</td>
<td>Balance of $100,000 on last day of year or $150,000 at any time during the year.</td>
<td>Balance of $400,000 on last day of year or $600,000 at any time during the year.</td>
</tr>
</tbody>
</table>

The determination of living or not living in the United States is made by applying the bona fide residence or physical presence test as applicable to the foreign earned income exclusion [7].

The third section of FATCA closes a tax loophole that investors had used to avoid paying taxes on dividends by converting them into non-taxable dividend equivalents.

It is the first section of FATCA is by far the most controversial, with significant push-back from foreign banking and government officials who are balking at requiring them to become “extensions of the IRS” and assuming a significant financial burden in attempting to comply. Few countries have entered into agreements to cooperate with the U. S. on FATCA. Discussions with other countries are under way. Some countries, such as China, have flatly refused stating that “China’s banking and tax laws and regulations do not allow Chinese financial institutions to comply.” In other countries, legal action has been initiated to stop FFIs from compliance [9].

One of the issues is that the U.S. is asking for information on American taxpayers, but is not offering some kind of reciprocity. Unfortunately, there does not appear to be much the U. S. has to offer here. Since most nations utilize a territorial tax system, reciprocity is not an important to most of these nations [9]. American Citizens Abroad (ACA) states that FATCA represents a legislative overreach on every foreign financial institution on earth by placing on them the obligation to examine whether and to what extend it must adhere to this law [1].

Of concern to many is the risk of foreign divestment of U. S. investments. The top 100 financial institutions worldwide have assets of approximately 78 trillion dollars. Two-thirds of this amount is controlled by non-U. S. financial institutions. Rather than comply with the U. S. law, some of these institutions have begun to avoid U. S. investments and closed accounts with U. S. taxpayers It is likely that this is only the start of a much larger movement, as more institutions are faced with compliance issues [1]. Even though a nation may agree for its financial institutions to comply with FATCA, the institutions probably can not be compelled to deal with U. S taxpayers.

The second section, requiring full disclosure of personal assets and bank account information on Form 8938 is of concern. As mentioned, this form is a part of the taxpayers’ annual income tax return. It is well-known that the Internal Revenue Service has issues in regard to tax-related identity theft. The complete taxpayer return will have the name, address, social security number (or other taxpayer ID number), and phone number in addition to detailed financial account information. This places U. S.
taxpayers at serious risk for identity theft. Americans living overseas are particularly at risk, as most of them would have a qualifying account in a foreign financial institution.

**SUMMARY**

This paper has examined territorial and worldwide tax systems. The United States is one of the few nations that have a worldwide system, putting itself out of step with most other developed countries in the world. Preserving the use of the worldwide tax regime creates enforcement and other problems as commerce becomes more and more global in scope. Some of these issues primarily create added complexity to the tax code. While not minimizing the issue of tax complexity, this is not the most serious negative effect of a worldwide system. However, in seeking to reduce tax complexity, changing to a territorial system would be a significant first step.

FATCA is an attempt to reduce the international tax gap but is not an effective solution and is fraught with financial and economic risk. It also creates strained relationships with other nations and their financial institutions with the burdens the U. S. is attempting to impose on these institutions. A territorial tax system would eliminate the need for solutions such as FATCA.

**BIBLIOGRAPHY**