

# International Tax – US Foreign Account Tax Compliance Act (FATCA)

✘ This article discusses how the US Foreign Account Tax Compliance Act (FATCA) is likely to affect all of us and contends that FATCA is not only of concern for United States (US) taxpayers; it is already affecting United Kingdom (UK) residents and its reach will soon extend to other taxpayers. Non-compliant taxpayers are watching a short fuse burning and that the records of the world's financial industry will be opened to unprecedented data mining.

FATCA has made waves in the upper reaches of the funds industry and caused concern to banks, custodians, insurance companies and trustees, but little news regarding its impact has yet spread to the wider world. Few ultimate clients of the international finance industry have yet heard of it.

This situation will change dramatically over the coming months and years.

## **The aim of FATCA**

All US citizens and green card holders are US taxpayers, whether or not they reside in the US, and all US taxpayers have extensive reporting, filing and taxpaying obligations with significant penalties for failure to file. The aim of FATCA is to oblige the international finance industry to report to the US Revenue Service (the IRS) on the international financial accounts of US taxpayers, on trusts in which they have interests and on companies and partnerships controlled, or deemed controlled by US taxpayers.

In 2009 the IRS decided it needed annual reports from the worldwide financial industry detailing, in respect of each and every account, the taxpayer's name, tax identification number,

and the associated account details including account numbers, balances and movements. The IRS justifies this demand on the basis that it will significantly enhance compliance by US taxpayers, both voluntarily and through informed enforcement.

### **The big stick**

Following the IRS decision, the US hit on the happy idea of compelling the world's financial industry to fall into line by using a big stick: the threat of withholding 30% on all payments derived from US investments. This is not the same as the withholding of 30% of interest and dividends which has been in place for years. The new withholding applies to all payments, including the payment of capital returned on disinvestment. The US is the largest recipient of inward investment in the world. It is very difficult for any international financial institution to operate without investing, directly or indirectly, in the US, or dealing with financial institutions that invest in the US. And so it became clear that the world finance industry would have to fall into line.

### **Intergovernmental agreements**

The US soon found there were snags. Separate compliance by worldwide institutions with the US FATCA is cumbersome. Many countries have rules about data protection, in some jurisdictions elevated to "banking secrecy", which prohibits compliance. The threat of withholding for non-compliance was perceived as threatening the continued operation of non-US financial centres, including the very largest centres, like London and Frankfurt.

As a result, the governments of countries with international financial industries have intervened and have concluded, or are concluding, "Intergovernmental agreements" with the US, which makes FATCA compliance legally possible and indeed compulsory, in such countries. In exchange, the governments concerned required some concessions from the US. Each agreement achieves freedom from FATCA withholding requirements

for the local finance industry. The agreements also purport to obtain reciprocal disclosure of information regarding accounts in the US of taxpayers in the relevant agreement jurisdiction, but delivering on this particular aspect seems to have run into constitutional difficulties in the USA.

### **The immediate task**

To comply with FATCA, the banks, insurers and custodian trustees of the world will have to check all their accounts as at 30 June 2014 when FATCA is scheduled to go live, to see if they have US taxpayers. This is a substantial task, which will take years and financial institutions will require many customers to fill in extra forms to make sure that their categorisation is correct. Despite continuing pressure on the US to allow more time, so far there has been no indication of further delay. Customers with US connections, who are the target of the investigation, will be most affected, but others will also be involved, even if a particular customer has no US connections. The finance industry will need to seek additional declarations from new customers to ensure that they are categorised properly.

On the basis of the categorisation of old customers and the additional information obtained on new customers, the finance industry will need to prepare reports, destined for the IRS. All this is an additional cost to the international finance industry. That cost will no doubt be passed on to some degree, and be absorbed by the finance industry to some degree. This task may not seem too serious. Information technology solutions will be developed to automate data collection and reporting. Perhaps there will be industry consolidation in the process of absorbing these costs and developing the solutions.

### **The consequences for you**

All the consequences mentioned above are essentially administrative and will be regarded as relatively minor by the customers.

But the real questions are:

- FATCA is already extended to UK taxpayers; will it extend to other taxpayers and if so, how quickly?
- What will be the consequences for all taxpayers of the “mining” of the data collected?

### **How far will it go?**

Tax authorities worldwide have seen that, once the machinery is in place, it is relatively easy for other jurisdictions to tag along. The UK and the US are conspiring with the rest of the world to extend the reach of this legislation worldwide. Already many European countries, including France, Germany, Spain and Italy, and a good number of other countries, such as Norway, Denmark and South Africa, have announced that they will sign up. Levels of non-compliance in different countries will vary, as will the level of sophistication of local tax authorities, but how long will it be before further countries join in? Will the programme not be attractive to the rest of Europe, South America, Africa, Canada, the Middle and Far East, and others? The G20 has asked the Organisation for Economic Co-operation and Development (OECD) to spearhead a program to ensure tax transparency between jurisdictions is the new norm. A conference of the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, which brings together 122 countries, was held in Jakarta, Indonesia, on 21-23 November 2013. The conference established a new group to monitor and review “automatic exchange of information” consistently with the G20 call.

### **A rush to comply?**

Taxpayers with historical, aggressive or non-compliant structures will no longer be able to rely upon lack of scrutiny.

Suppose you have an offshore trust with a legitimate history, your safety net, which you have never needed to touch or report? Your local tax authorities will have a new window on

your international affairs and an opportunity to discuss with you whether your historical planning really did work as well as you think.

Suppose you are an “accidental” US citizen who has never lived in the US and you forgot to file with the IRS your annual “Foreign Account Balance Report” on your UK bank account. The IRS will know. The penalty can be a percentage of the account balance.

Perhaps you are a UK resident who still has a bank account in the Cayman; or a trust you established in the Turks and Caicos Islands and a company in the British Virgin Islands which you are reluctant to disclose. HMRC will have it on file.

If you are a resident of one of the countries which have expressed an interest, but which have not yet rolled out their own “tax transparency” program, perhaps you have a little more time. But the automatic exchange of information initiative seems unlikely to falter. The world’s finance industry will reluctantly but unavoidably become a policeman for tax authorities, reporting automatically back to the authorities in a tax-collector friendly manner. It is likely that every institution will ask for your place of tax residence and tax number; and as countries join the program, so reports will start to be filed carrying your number which will be returned to your country of tax residence, and no doubt the report will be linked with your tax return.

As a result a large amount of additional data about the international affairs of taxpayers will be available to fiscal authorities throughout the world. The opportunities for data mining are manifest.

### **The end of “offshore”?**

Is privacy still a significant “unique selling point” of the offshore world? And if so, from whom? These jurisdictions claim to be properly regulated, flexible, tax neutral offshore

platforms. But to what extent do they still shelter aggressive planning which has survived solely or partly because of lack of scrutiny?