FACTCOALITION
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Briefing Memo: FATCA

Questions & Answers about the Foreign Account Tax Compliance Act (FATCA)

What is FATCA?

FATCA is the **Foreign Account Tax Compliance Act,** which was adopted in 2010 to help pay for the HIRE (Hiring Incentives to Restore Employment) Act. FATCA requires foreign financial institutions (FFIs) to determine if accounts they have opened are held, directly or indirectly, by Americans and, if so, disclose them to the Internal Revenue Service (IRS).[1] Any FFI that refuses to provide this information to the United States is subject to a 30% withholding tax on the FFI's U.S. source income.[2]

Some foreign countries objected to the U.S.'s new requirement for a variety of reasons. Instead of allowing their banks to provide account information directly to the IRS, some foreign governments negotiated with the U.S. Treasury to allow the governments to aggregate the account information from their banks and provide it to the U.S. on a reciprocal basis[3]. The negotiations led to bilateral FATCA agreements between the foreign governments and the U.S. The United States now has FATCA Inter-Governmental Agreements (IGAs) in place with 113 foreign jurisdictions.[4]

Why was FATCA enacted into law?

Investigations by the U.S. Department of Justice, IRS, and Congress found that tens of thousands of U.S. taxpayers had opened accounts at foreign banks, failed to report those accounts to the IRS, and evaded paying billions of dollars in U.S. taxes. FATCA was enacted to require foreign banks to disclose their U.S. client accounts to the IRS in the same way that U.S. banks already disclose their client accounts to the IRS, thereby clamping down on offshore tax evasion and protecting honest taxpayers.

[1] Any account with "substantial U.S. ownership" which is:

a. For corporations: any specified United States person (USP) which owns, directly or indirectly, more than 10% of the stock of such corporation (by vote or value),
b. For partnerships: any specified USP which owns, directly or indirectly, more than 10% of the profits interests or capital interests in such partnership, and
c. For trusts: any specified USP treated as an owner of any portion of such trust under subpart E of part I of subchapter J of chapter 1 [of the Internal Revenue Code of 1986].

[2] "FATCA Information for Foreign Financial Institutions and Entities". *Internal Revenue Service.* May 31, 2016 (accessible at https://www.irs.gov/businesses/corporations/information-for-foreign-financial-institutions).

[3] "FATCA Information for Governments". *Internal Revenue Service*, March 24, 2017 (accessible at https://www.irs.gov/businesses/corporations/fatca-governments).

[4] "Foreign Account Tax Compliance Act (FATCA)". *U.S. Department of the Treasury.* March 29, 2017 (accessible at https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx).

Does FATCA impose any new tax obligations on Americans with foreign accounts?

No. Americans have long been required by U.S. law to report their foreign income and their foreign bank accounts to the IRS. [5] FATCA does not impose any new or additional tax to be paid by Americans with accounts abroad. By requiring foreign banks to disclose high-dollar accounts opened by U.S. persons, however, FATCA does help the IRS locate Americans using offshore accounts to evade paying U.S. tax.

It is important to understand that, under longstanding U.S. law, Americans are required to pay U.S. tax on income that they earn wherever they earn it. That means an American living and working in Norway is expected to pay U.S. income tax on their Norwegian income. In order to ensure that Americans living and working abroad are not subject to double taxation, the first approximately $100,000 of their foreign income is not subject to any U.S. tax at all under the Foreign Earned Income Exclusion.[6] An American can also offset their U.S. tax liability on income above $100,000 by taking a tax credit for any foreign tax paid on that income.[7] Due to those tax credits, an American living and working in Norway will be unlikely to ever pay U.S. tax on any income earned there, because Norway's income tax rate is higher than the U.S. rate and the taxpayer will be given credit for the Norwegian taxes already paid.

If FATCA were repealed, would Americans living abroad get a tax break?

No. FATCA does not impose any tax on Americans living abroad. If FATCA were repealed, U.S. citizens living abroad would still be under a legal obligation to pay the same amount of U.S. tax on their worldwide income.

Does FATCA require disclosure of all foreign accounts or only high-dollar accounts?

FATCA requires disclosure of only high-dollar foreign accounts. Under FATCA, foreign financial institutions are required to report to the IRS foreign accounts held by Americans living abroad only if an account has an end-of-year balance of more than $50,000 or had greater than $75,000 at any time during the year. Those dollar thresholds mean that FATCA requires disclosure of only high-value foreign accounts.

Is the U.S. the only country with this kind of account information-sharing requirement?

No. In 2003, the European Union adopted the EU Savings Directive which required each EU Member State (currently 28 countries) to provide information about accounts held by another EU Member State's nationals. For example, since 2003, Spain has been required to provide information to Germany about interest paid on accounts in Spanish banks held by German citizens so that Germany can properly assess taxation, and vice versa. In light of the success of the EU Savings Directive and FATCA, the

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[5] This separate disclosure requirement, in its current form, is known as FBAR (Report of Foreign Banks and Accounts). See, "Report of Foreign Bank and Financial Accounts (FBAR)". *Internal Revenue Service*. February 27, 2017 (accessible at https://www.irs.gov/businesses/small-businesses-self-employed/report-of-foreign-bank-and-financial-accounts-fbar).

[6] "Foreign Earned Income Exclusion". *Internal Revenue Service*. June 22, 2016 (accessible at https://www.irs.gov/uac/newsroom/foreign-earned-income-exclusion-2016).

[7] "Foreign Tax Credit". *Internal Revenue Service*. December 16, 2016 (accessible at https://www.irs.gov/individuals/international-taxpayers/foreign-tax-credit).

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Organization for Economic Cooperation and Development (OECD) created a global framework under which almost any country in the world can exchange account information with another country.[8] The technical and operational standards for that information exchange are set out in the Common Reporting Standard,[9] which replaced the Directive is closely modeled on the standards developed for FATCA. Financial institutions complying with FATCA are, thus, easily able to also comply with the OECD model. As of April 2017, 100 countries have agreed to begin exchanging information under the OECD model either by the end of 2017 (the first wave) or by the end of 2018. [10]

Are foreign banks refusing to open accounts for Americans living abroad?

While, several years ago, some foreign banks did close accounts held by Americans or stopped opening new accounts for Americans in order to avoid FATCA's compliance requirements, there appears to be no country in which Americans are unable to find banking services. Today, thousands of foreign banks have made the changes needed to comply with FATCA, the EU Savings Directive, and the OECD information exchange model, and are fully equipped to handle American clients. As noted above, 113 countries have entered into FATCA agreements with the U.S., and 100 countries have committed to FATCA-style information exchanges, which means Americans are no longer of special concern.

Does FATCA subject U.S. citizens living abroad to IRS penalties in cases where they were unaware of their obligation to pay taxes on their worldwide income ("inadvertent non-payment")?

No. The IRS is aware that some Americans living abroad were unaware of their U.S. tax obligations until the news about FATCA made them realize that they should have been filing U.S. tax returns and paying applicable U.S. taxes. In response, the IRS created the Streamlined Filing Compliance Procedures in 2012 to allow folks to get caught up. [11] The program includes abatement of taxes owed and penalties assessed, if the taxpayer certifies that the failure to file was not willful on their part.

Taxpayers who can make such a statement have to file tax returns for only the prior three years and pay any taxes owed; at the same time, they "will not be subject to failure-to-file and failure-to-pay penalties, accuracy-related penalties, information return penalties, or FBAR penalties."[12]

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[8] Countries must sign the multilateral Convention on Mutual Administrative Assistance in Tax Matters to be eligible to participate. See, "OECD and Council of Europe (2011), *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol*, OECD Publishing. http://dx.doi.org/10.1787/9789264115606-en

[9] OECD (2017), *Standard for Automatic Exchange of Financial Account Information in Tax Matters, Second Edition*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264267992-en

[10] "AEOI: STATUS OF COMMITMENTS (100 jurisdictions have committed)". *Organisation for Economic Co-operation and Development*. April 10, 2017 (accessible at https://www.oecd.org/tax/transparency/AEOI-commitments.pdf).

[11] "Streamlined Filing Compliance Procedures". *Internal Revenue Service*. February 22, 2017 (accessible at https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures).

[12] "U.S. Taxpayers Residing Outside the United States". *Internal Revenue Service*. February 22, 2017

The IRS even has a special program for taxpayers who *did* know about their obligation to file returns and pay taxes, but decided to engage in tax evasion anyway. The Offshore Voluntary Disclosure Program enables those taxpayers, in most cases, to catch up on their taxes with reduced penalties.[13]

Are U.S. citizens giving up their citizenship because of FATCA's requirements?

No data or statistics are currently available which indicate why a person gives up their U.S. citizenship, which may be for a number of reasons. IRS statistics indicate that 4,279 people gave up their U.S. citizenship in 2015[14], while that same year, 729,995 new citizens were added to the rolls according to U.S. Citizenship and Immigration Services[15], for a net increase of more than 725,000 taxpayers. According to the U.S. State Department, about 9 million Americans were living abroad in 2015,[16] so even with the completely unfounded assumption that every single person who gave up their citizenship that year did so because of FATCA, FATCA caused only 0.05% of Americans living abroad to give up their citizenship. That is less than one tenth of one percent.

Again, FATCA does not impose any new tax on U.S. citizens; it simply increases transparency regarding their high-value foreign accounts. If U.S. citizens give up their citizenship "because of FATCA," they may be doing so because they don't want to pay U.S. taxes and believe they can no longer evade those taxes by placing their assets in an undeclared foreign account.

Will repealing FATCA reduce compliance costs for banks?

No. At this point, most banks have already put the necessary systems and technology in place to comply with FATCA, the European Savings Directive, and the OECD's automatic exchange of account information under the Common Reporting Standard. Those investments have already been made, and the technology would continue to be needed for the European initiatives even if FATCA were repealed.

For additional information, please feel free to contact Clark Gascoigne at cgascoigne@thefactcoalition.org.

[13] "Offshore Voluntary Disclosure Program. *Internal Revenue Service*. March 9, 2017 (accessible at https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program).
[14] "Quarterly Publication of Individuals, Who Have Chosen to Expatriate". *Internal Revenue Service.* N.d.
[15] "Naturalization Fact Sheet". *U.S. Citizenship and Immigration Services*. December 8, 2016 (accessible at https://www.uscis.gov/news/fact-sheets/naturalization-fact-sheet).
[16] "CA By the Numbers". *Bureau of Consular Affairs*. June 2016 (accessible at https://travel.state.gov/content/dam/travel/CA_By_the_Numbers.pdf).

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