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The FATCA Tornado Hits Ground

a. Background information about FATCA

When you drop a large rock into a pool of calm water, ripples appear and spread and eventually they will touch the entire surface of that pond, drastically changing its appearance. And the FATCA rock was a very big one indeed.

Recognizing that there is a substantial amount of money stored overseas that has gone unreported – and that will continue to go unreported if the government doesn't put teeth into its veiled threats to taxpayers to "disclosure [their] foreign accounts *or else*" – Congress passed FATCA. FATCA requires foreign financial institutions (FFIs) to report specific information regarding their U.S. accountholders to the IRS.

It was passed in 2010 to clamp down on the use of foreign bank accounts by U.S. taxpayers to hide money that is otherwise subject to taxation in the United States. FATCA is the U.S. government's newest enforcement tool in the fight against international tax evasion.

To avoid any confusion, it's important to emphasize that it is *not* illegal for a U.S. taxpayer to own an overseas bank account. Overseas financial accounts are maintained by U.S. taxpayers for a variety of legitimate reasons.

Below are three reasons why a U.S. person might own a foreign bank account:

- Reason # 1: In the not too distant past, wealthy Americans and "wannabe" wealthy Americans found it convenient and/or fashionable to put much of their wealth in offshore financial institutions. Although it was not the only player in this game, Switzerland attracted much of the American wealth which was stored offshore. There are many countries in the Caribbean as well as Israel who were more than willing to provide this service, but Switzerland was the biggest name in the industry.

- Reason # 2: Convenience and access. In today's global marketplace, many U.S. citizens have relocated abroad. Thus, maintaining an account with a local bank in order to conduct day-to-day affairs is an absolute necessity (i.e., to pay rent, phone, insurance, wife, and electric bills, buy groceries, and so forth).

- Reason # 3: The taxpayer may have inherited a foreign bank account from a relative back in "the old country."

b. The Carrot and the Stick

FATCA gets its teeth from two provisions:

- Non-compliant foreign financial institutions face a mandatory 30% withholding on payments from U.S.-based financial institutions.

- FATCA also beefed-up the ability of the Department of Justice to prosecute financial institutions criminally who were assisting U.S. taxpayers with tax evasion.

c. FATCA Backlash

i. From the Perspective of Foreign Banks

What is it about this pestilent law that engenders such strong emotions? From the perspective of ***foreign banks***:

1. It turns foreign banks and financial institutions into enforcement arms of the Internal Revenue Service (IRS). This allows the IRS to make sure they are collecting every possible dollar from U.S. taxpayers who have offshore assets.

2. Although they seemingly have two "options" – disclose account information on clients who are U.S. persons or pay a whopping 30% of all payments they receive from America to the IRS – most foreign financial institutions would argue that they have only one real choice if they want to be around long enough to report next year's quarterly earnings. And that is to succumb to Uncle Sam's heavy-handed demands and turn over U.S. accountholder information.

ii. From the Perspective of U.S. Taxpayers with Unreported Foreign Accounts

From the perspective of ***U.S. taxpayers with foreign accounts***, it treats every taxpayer with an unreported foreign bank account as though they are "Al Capone," a stereotype that defies reality. How so? The penalties are so exorbitant that it could leave taxpayers with nothing more than the shirt on their backs. For example, willful FBAR penalties are the *greater* of $ 100,000 or 50% of the closing balance in the account as of the last day of filing the FBAR. Considering the fact that FBAR penalties are assessed per account, and not per year, this could drive a taxpayer's FBAR penalties into the penalty stratosphere!

In addition to the draconian penalties, many U.S. expats are facing discrimination by being denied access to banking and financial services in foreign countries. For example, many foreign financial institutions have thrown up their hands and decided that foreign accounts simply aren't worth the regulatory hassle or potential financial costs. Essentially, they would rather turn down new clients than deal with the "political baggage" – not to mention the 30% withholding tax – that comes from taking on another U.S. expat as a customer.

The impact that this could have on the U.S. expat community is sweeping. Simply stated, fewer banks means less competition. That means higher fees, fewer perks, and fewer choices. Taken to the extreme, if enough banks take a page out of the playbook of the Central Bank of Seychelles, the most recent bank to have announced that it was "restricting business relationships with high risk clients or categories of clients to avoid the risk of sanction," this could mean no financial institutions for expats at all.

Either way, FATCA may amount to an unconstitutional taking, at least on some level. Senator Rand Paul's lawsuit to stop FATCA raises some of these same issues, but there is no telling how that lawsuit will end up. (See "FATCA Under Fire" below).

Before going any further, let's clear up a misconception. The vast majority of taxpayers with unreported foreign accounts are *not* tax cheats. If they are not tax cheats, then why might such a person *not* report their foreign accounts? For starters, many simply did not know that they had a reporting obligation to begin with, let alone that it applied to them. Nor did they know that they had an obligation to report their foreign-source income on a U.S. tax return. These folks thought that they had satisfied their U.S. tax obligations by virtue of having reported their foreign-source income on a foreign tax return and having paid taxes to the foreign taxing authority. The complex U.S. international tax regime certainly did not help to clear up any of this confusion.

Others knew exactly what their U.S. tax obligations were but because they owed little or no U.S. tax (after accounting for the taxes they paid to the foreign government), they thought that the IRS would care less.

iii. Critics Weigh In

Those that denounce the law criticize its complexity, its expansive reach, and the high cost of compliance. Paraphrasing, their argument sounds something like this: "With FATCA, the U.S. government has found a very effective way to bully foreign governments and financial institutions into giving it previously unobtainable information on U.S. taxpayers."

Those that like it (and there are a few) argue that it will blow the lid off of "the old way of

exchanging tax information between countries on request," which they view as too lenient on tax cheats. FATCA, they predict, will revolutionize the exchange of information, by making it "automatic," thereby removing any safe harbors for those who have, shall we say, less-than-pure motives.

d. Hypocrisy?

As more countries are pushed to the brink to share tax information and reluctantly acquiesce to the U.S. government's heavy-handed demands to board the "FATCA" Express, the focus will shift to America's willingness (or unwillingness) to reciprocate. Who can forget the expression, "What's good for the goose is good for the gander?"

Hypocrisy? While the U.S. has agreed to share information about non-U.S. taxpayers who have stuffed money into U.S. banks with its FATCA partners, the fact remains that it does not provide the same amount of information about non-U.S. accountholders who bank with U.S. banks that it demands from foreign governments under FATCA. On the contrary, the U.S. provides *less* information.