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FATCA Is Far from a Done Deal

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Largely affecting those banks outside of the U.S., the Foreign Account Tax Compliance Act requires all foreign financial institutions to report the activities of their American clients to the Internal Revenue Service. But given the recent demands from other nations hinting at reciprocity, the overreaching legislation could impact banks and financial institutions in the U.S. as well.

Now, there is the additional element of certain key countries rejecting FATCA outright, and the Asia-Pacific region could end up holding the most sway.

Cited as a hindrance to foreign investment that would ultimately dampen U.S. economic growth and threaten American jobs, the FATCA penalties for noncompliance provide a strong incentive for overseas investors to avoid U.S. depository institutions altogether. Tax Management International Journal cites 11 reasons why FATCA must be repealed. Reason number one is "the height of arrogance."

It is either the reciprocity angle or the cascade effect of China's reluctance that has the greatest potential to derail FATCA.

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>
> — Brian Mahany
> Mahany & Ertl LLC

"The United States should be moving toward full reciprocity," Georgetown Law School Professor Itai Grinberg, a former Treasury official, told Reuters. He added that it would be "deeply hypocritical" for the U.S. to ask for information on American taxpayers "without offering some kind of reciprocity."

Because direct reciprocity may mean foreign banks violating the privacy laws of their own jurisdictions, the Treasury Department has started negotiating bilateral agreements so that foreign governments can aggregate the bank data necessary for the IRS.

Attorney Brian Mahany of Mahany & Ertl, a law firm specializing in offshore reporting and compliance, believes that reciprocity is a bit misleading. "We are one of the few countries that tax based on worldwide income. Reciprocity isn't as important to most other nations," he added.

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Also, the U.S. is one of the worst offenders globally when it comes to tax havens and "secrecy jurisdictions." For instance, Mahany said "many people, including Chinese nationals, hide money here." While President Obama has asked Congress for reciprocity, he is dealing from a position of weakness. "The support for FATCA is not very strong," Mahany added.

However, with global financial transparency on the increase and more countries considering taxation on citizen's worldwide income as a way to combat growing budget deficits, reciprocity with U.S. financial institutions starts to look appealing.

On the China issue, Mahany concedes that the U.S. government will never get every nation to join FATCA and the Asia-Pacific countries are heavily influenced by Beijing. He states, "China is certainly an important player. Currently, none of the Asian-Pacific countries are signed up, although Japan will probably be the first. Without Singapore, China, Hong Kong and Macau, FATCA faces real challenges."

James Jatras of the Repeal FATCA campaign claims that Hong Kong, like the People's Republic of China, is not even on the list of 50 countries the Treasury claims to be negotiating with.

There will probably be so few U.S. citizens holding bank accounts in China that the cost of implementing FATCA outweighs the benefit to China's financial institutions. Also, the Chinese taxpayers with U.S. bank accounts appear to be of minimal interest to the Chinese government, according to Lisa Smith of iExpats.com.

"Before rushing to safe keep all your money in Communist China, remember that even if China elects to ignore FATCA, they may still cooperate with the IRS on a case-by-case basis," according to Mahany. China and the U.S. signed a Mutual Legal Assistance Agreement in June of 2000.

However, none of this potentially disruptive turmoil means that financial institutions should put FATCA-related IT infrastructure plans on hold until China makes its decision, because foreign banks and other financial institutions are currently ill-prepared for FATCA.

According to Mahany, "Implementation has been delayed once but folks should not depend on that happening again. The penalties for not complying outweigh the risks of noncompliance."

Meredith Moss of Finomial believes "that a technology solution is the only way to go, given the tremendous amount of data, PDFs and paper documents to sift through." She says that banks moving forms online and creating a comprehensive FATCA audit trail will demonstrate diligence to the regulators and that "due diligence should be underway by January 2014 and completed by July 2014."

Although experts in the FATCA preparation business tend to agree that moving forward with expensive FATCA compliance plans is the prudent and logical step to be taking now, a comprehensive and worldwide FATCA rollout is far from a foregone conclusion. For those financial institutions and their shareholders offended by the overreaching legislation and lack of respect for mutual sovereignty, the cost savings alone may start to make FATCA's non-compliance penalties look tolerable. ■