What FATCA Means to the American Expatriate

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The IRS is at it again – making life more difficult for US citizens living abroad in its zeal to rake in tax dollars.

A few years ago the IRS launched a major effort to combat money-laundering and tax evasion by US taxpayers using non-US financial accounts. No doubt you have read about how even the secretive Swiss banks have been brought to heel by the IRS and the US government. UBS, a Swiss-based financial conglomerate, has divulged the names of their US clients to the IRS (and received considerable fines for helping to hide clients' money from the IRS). Other financial institutions in Switzerland and a number of other countries have followed suit.

In addition, the IRS has offered a number of "amnesties" to US tax-payers who have not been declaring their foreign accounts. These amnesties involve payment of tax and penalties in exchange for avoiding further prosecution.

These programs have been so successful that the IRS has come to realize that there is a great deal more they could do – and so now we have FATCA, the Foreign Account Tax Compliance Act. The IRS has apparently realized that it alone does not have the manpower to pursue all US taxpayers living abroad and so, through this Act, it seeks to make all non-US financial institutions partners in their tax evasion efforts.

FATCA affects American expats (for the sake of this article the term "American expat" should include non-US citizens with US tax obligations) in two broad ways.

On a personal level, there is another IRS form to be completed, form 8938, which asks about your foreign assets (not just financial accounts, but also other holdings, such as non-US businesses). This form is in addition to the US Treasury "FBAR" form that needs to be filed if a taxpayer has foreign financial accounts holding greater than $10,000 in aggregate.

The extra form is just an inconvenience and in fact does not even apply to many American expats whose non-US assets fall below certain minimums. The real meat of FATCA is at the institutional level – the reporting it seeks to impose on non-US financial institutions.

In essence, FATCA seeks to turn foreign financial institutions (FFIs) into reporting agencies for the IRS. Here is how it works in a nutshell:

- FATCA is phased in over the next several years starting beginning of 2013.
- FFIs will have to check their clients' accounts for "indicia" of US ties; things such as a US mailing address, income from US sources, birth in the USA, etc.
- If such indicia are found, the FFI must request certain information from the account holder to confirm whether they may be subject to US tax.
- If the account holder does not provide such information then the FFI must report the account to the IRS and may have to withhold on any income payable to the account holder.

As you can imagine, these regulation place a considerable time and cost burden on non-US financial institutions, so one might ask why they simply wouldn't tell the IRS to get lost. The reason is two-fold: First of all, since this is all in the interest of combatting money-

laundering, FFIs and governments feel a moral obligation to act. Secondly, the IRS will impose a 30% withholding on US source income to the FFI if they do not comply.

You may ask what the big deal is since most likely you are like the vast majority of American expatriates and are not trying to hide your income from the IRS and don't mind disclosing that you are a US tax-payer. The big deal is that the alternative for FFIs to reporting to the IRS is to simply get rid of any client who has any ties to the US – they may feel that it simply isn't worth the bother, especially for smaller accounts, to deal with US clients. So, as if it isn't already difficult enough for Americans living abroad, it may become yet more difficult thanks to FATCA.

The "good" news from this regard is that so far it seems like many governments and FFIs are choosing to comply with FATCA. In many cases there are local privacy laws that do not allow disclosure of FFI client information but the workaround seems to be that the FFI discloses the information to a local government agency and this agency reports to the IRS (as is the case in Mexico for example). This is good news in the sense that US clients are not being thrown out by the FFIs.

There is another interesting, and potentially more important, aspect to FATCA in that the agreements being entered into by foreign governments most often call for exchange of information rather than just sending information to the IRS. That is, US institutions will have to report on their non-US clients to the appropriate foreign government under the FATCA-based reciprocal agreements.

This has implications not only for non-US citizens with US accounts but also for US citizens living abroad. The greatest FATCA issue for American expats may end up being that their US bank or brokerage may no longer want to deal with them. The fact is that most US financial institutions have relatively few non-US resident clients – so they might decide that it isn't worth the hassle to comply with these reciprocal reporting requirements. Imagine if you run a US bank, and you have some customers who live outside the USA but they are scattered in various countries, each of which requires reciprocal reporting under FATCA – what a mess. Now imagine if you have an IRA or 401k with a US financial institution that decides to get rid of their non-US resident clients – that could be a real issue. Furthermore, many US expats living in countries where, shall we say, tax reporting is not a priority, are not even aware of their local tax obligations with respect to their US accounts – they could be in for a nasty surprise somewhere down the line.

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