




# FRATCATA



# FATCA: The Effects on Americans Overseas

*The Foreign Account Tax Compliance Act (FATCA) – a law passed in 2010 to tackle the abuse of using offshore financial accounts for the purpose of evading US taxes – is now in effect after a two-year delay. As it requires foreign financial institutions worldwide to identify and report to the US all financial accounts owned by US citizens and Green Card holders, many Americans are facing an enormous challenge while living and working abroad amid an expanding regime of regulations*

By **Kenny Lau**

**I**t all started back in early 2009 when UBS of Switzerland entered into a Deferred Prosecution Agreement with the US government and agreed to turn over information of thousands of “suspicious” accounts held by US citizens and Green Card holders. It marked a new era of government regulations cracking down on tax dodgers alleged to be hiding their assets with overseas bank accounts.

The Foreign Account Tax Compliance Act (FATCA) – as a part of the Hiring Incentives to Restore Employment Act (HIRE) designed for job creation amid high US unemployment – was subsequently passed in 2010 to tackle the abuse of using offshore financial accounts to evade US taxes. The new law went into effect on July 1, 2014, after a two-year delay.

By now, it is well understood that FATCA requires foreign (non-US) financial institutions (FFIs) and certain non-financial foreign entities (NFFEs) worldwide to identify and report to the US Internal Revenue Service (IRS) all financial accounts held by US persons. It also imposes a 30 percent withholding tax on

US-source income of institutions that are deemed non-compliant.

In other words, FATCA serves as a reporting system for US tax compliance by requiring all banks and financial institutions on a global basis to submit information of their US clients about any existing accounts. When a bank fails to do so, it risks having 30 percent of its funds (to be transferred from US sources) withheld by the US Department of Treasury – and potentially being shut out from the global financial system by being disallowed to clear transactions denominated in US dollars.

Because of its nature as a law to combat offshore tax evasion through a worldwide reporting regime, FATCA has had a significant impact on the lives and competitiveness of Americans living and working abroad as a result of the social, economic and legal implications of the new law.

## **Guilty unless proven otherwise**

The basic principle of FATCA is the assumption that every financial account held by US citizens overseas is potentially used for the purpose of

evading US taxes, notes Michael DeSombre, Worldwide President of Republicans Overseas and a resident of Hong Kong for 17 years. "The thought that an American living in Switzerland is assumed to be engaged in nefarious activities by having a Swiss account is completely unfounded."

"Every American who has come to live in Hong Kong needs to have a bank account here simply because he or she needs to be able to write checks and pay utility bills just like anywhere else," he says. "It would at least make a little bit more sense if the law were limited to disclosure of overseas account information from those who live in the US but might not otherwise in general have reasons to have an overseas bank account."

"Likewise, Green Card holders in the US actually fall in the same camp of overseas Americans because it is quite likely that they would retain bank accounts in their home country," he adds. "Again, to presume that a US permanent resident living in America and having a bank account in his home country is engaged in nefarious activities is just as silly."

The number of Americans living abroad is estimated to be 7.6 million worldwide – from whom there are about 440,000 IRS tax forms filed for Section 911 Foreign Earned Income Exclusion every year, DeSombre points out. "The vast majority of overseas Americans who are not filing US taxes are not trying to evade taxes but in most cases simply believe they do not need to file because they do not owe anything or they know they fall underneath the exemption threshold allowed under Section 911."

"Previously, if you did not owe any taxes it was not a problem that you did not make any filings, but this is no longer the case under FATCA," he says. "Nonetheless, I am sure there are some American residents overseas that are trying to evade US taxes, and those persons should be prosecuted. I do not believe, however, that tax evaders represent a significant percentage of Americans overseas."

## Unintended consequences

Banks and financial institutions around the world have been scrambling to put in place their own system of due diligence and building up an infrastructure for the purpose of identifying those who may be subject to US tax liability. Yet, because the requirements for FATCA compliance are so cumbersome, there are an increasing number of cases in which Americans are reportedly denied banking services, particularly among those seeking to open a new account.

"Because of the various regulatory requirements, more and more financial institutions are finding it disadvantageous to have American citizens as clients in their system," DeSombre says. "Banks around the world, particularly the smaller ones, are very, very reluctant to open an account for US citizens. There are people whom I know have been denied banking services just because they are Americans."

"The largest effect is on business accounts for overseas companies owned by Americans," he further points out. "It's nearly impossible for an American citizen as an owner or a majority holder of a company to go to any bank in Hong Kong and get them to open a business bank account. While some banks may still be willing to open a basic checking account, they just won't do any investment accounts."

The impact on Americans living and working abroad has gone far and beyond. "Whether you are a teacher working in China or a senior business executive running a multinational company in Hong Kong, you are affected as long as you are American," DeSombre sighs. "When you go abroad to have a job, you can't open an account to pay your bills. When you are finally able to earn more money, you can't invest it for your future. So, you're essentially robbed of your freedom."

"I know of people who have given up their US citizenship because they are afraid that they couldn't comply with all the legal requirements," he says.



Michael DeSombre

"These people are more than willing to fulfill their US tax obligations but are very concerned about getting something wrong in a tax filing, and they now carry a Hong Kong passport even though they don't speak any Chinese or have any family roots here."

"The fact that they are being forced to abandon their US citizenship to pursue the American dream of being an entrepreneur and starting a business really speaks volumes," he adds.

## US competitiveness

Americans living and working abroad with people of different cultures and backgrounds are an important part of US foreign policy – they are often the unofficial ambassadors to countries around the world. Having lived in Hong Kong for 17 years, DeSombre is an example of an overseas American working for an American company and exporting American products and services.

"Having Americans working overseas and running US companies is critical for our goal of increasing US export of goods and services," he believes. "These are entrepreneurs who create US jobs and play an important role in helping the US sell American-made products."

The benefits are simply enormous "when you have a strong presence of

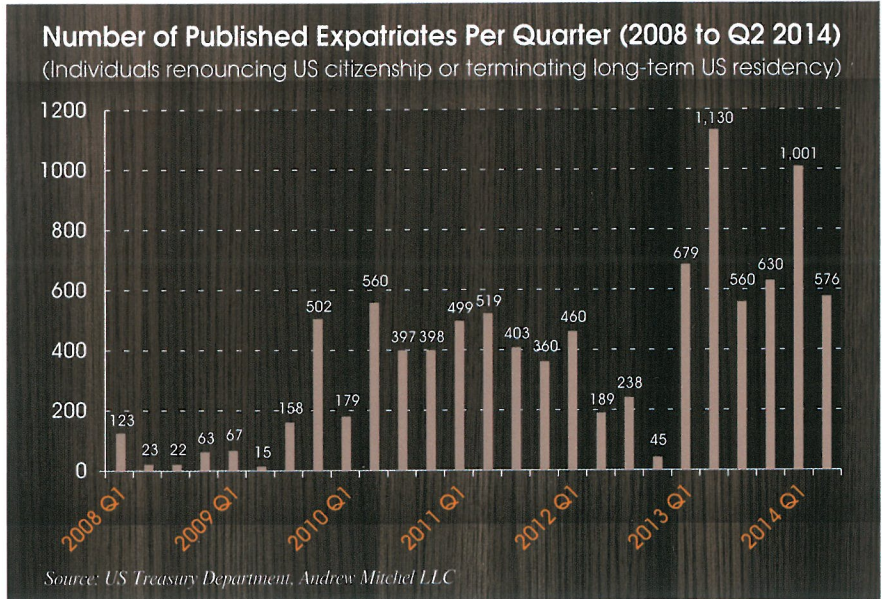
Americans overseas,” he says. “You’ll find that, wherever they may be, they end up using American washer and dryers at home, they end up outfitting their offices with equipment that originates from the US, and they are certainly much more likely to be buying and selling American products.”

“The most important aspect – again – is one of entrepreneurship. We have many cases where Americans are highly successful in developing and running global businesses not only here in Hong Kong but around the world,” he adds. “They have certainly achieved a great deal. But, if you make it needlessly difficult for them, they will not have the incentive to continue doing it.”

From an employer’s perspective, it has simply become much more expensive to hire Americans for jobs overseas. As a result, companies are all moving towards other nationalities to fulfill their needs for human resources from any country except the US. That’s because US is the only industrialized country that levies income tax based on citizenship rather than residence – and regulations such as FATCA are making it even harder for US citizens to compete in a foreign country.

“At some point, people will either stop going overseas or renounce their US citizenship – which has been a growing trend in the last few years,” DeSombre says. “The number of Americans giving up their US passports has indeed doubled in 2013, and it looks to be going up even higher. Strangely, rather than addressing the root causes of such expatriation, the US government decided instead to increase the cost of filing for expatriation by 422 percent, from US\$450 to US\$2,350.”

The bottom line is that “when Americans are discouraged to live and work overseas, it really decreases our national competitiveness in a highly competitive world,” he stresses. “And, you’d want Americans working abroad to drive US exports and to attract investment back to the US, especially when there’s high unemployment and slow economic growth.”



## Constitutionality

Critics of FATCA have often cited the new law to be an infringement of freedom and the right to privacy of overseas Americans. “The fact that overseas Americans need to report all of their financial information of any asset or bank account to the IRS is staggering,” DeSombre says. “Conversely, in the US, the IRS must have reasonable cause and get a subpoena to be able to retrieve bank account information.”

“The increase of tax revenue expected from FATCA is relatively small. Yet, the price we have to pay in terms of our freedom and privacy is tremendous,” he notes. “If the police had the right to raid everybody’s home and search for potential evidence of a crime without a warrant, I bet our crime rate would be lower. However, we’ve decided as a government, as an institution and as a people that such intrusion on our privacy would not be appropriate.”

“I am fully in support of going after tax cheats. There is no question about that,” DeSombre stresses. “But, to go after a small number of people in a way that takes away the freedom of 7.6 million Americans overseas is overreaching. Whether Americans are in the US or abroad, our freedom is recognized in the Constitution.”

“Obviously, the fact that some people are not paying their taxes bothers me immensely because we should all be meeting our tax obligation,” he says. “I have no sympathy for those who evade taxes, whether they are wealthy or not; however, we should go after them in a targeted way, not by removing the freedom from all of us.”

“This is ultimately a bipartisan issue – whether you are a Democrat or Republican, you have the same concerns,” he further notes. “It goes back to the question whether it is worth the freedom of every single American overseas. The answer from the US Constitution is clearly no.”

## Legal grounds for a challenge

With chapters in 40 different countries, Republicans Overseas has been garnering support from US officials and elected representatives to address the issues of FATCA deemed insensibly onerous. It is about to launch a challenge to the constitutionality of FATCA in a US court of law on three major legal grounds.

The Intergovernmental Agreements (IGAs) are bilateral agreements signed between the US and partner countries and are designed to facilitate compliance for FATCA. There are two

types of such agreement: Model 1 requires a foreign government to report to the IRS information collected from financial institutions within its jurisdiction, whereas FFIs report directly to the IRS under Model 2 without involving a foreign government.

Model 1 IGAs can be challenged under the Treaty Clause of the US Constitution because they have not been submitted to the US Senate for its advice and consent, DeSombre points out. "These are essentially treaties with foreign governments. Before we sign a treaty, we need to have it ratified by two-thirds of the Senate. Because this has not been properly done, Model 1 IGAs can be rendered unconstitutional."

Secondly, excessive reporting of personal information is a violation of the Fourth Amendment to the US Constitution by which "the right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures" is guaranteed.

"When FFIs are required by law to report every single detail of your financial information of every US citizen abroad to the IRS unconditionally, it is in reality seizure without probable cause or warrant," DeSombre explains.

Thirdly, FATCA can be deemed a violation of the Eighth Amendment due to "cruel and unusual punishment" in the form of excessive fines and penalties. The 30 percent withholding tax (to be imposed on FFIs for noncompliance) "is not a tax but a penalty designed to compel financial institutions to comply with FATCA" and "is grossly disproportionate to the offence of not complying with FATCA's mandates."

Similarly, fines and penalties also apply to the individual American. "If you have a bank account with \$100,000 and haven't declared it for four years, you can be fined up to \$50,000 for every one of those four years and could theoretically end up getting a \$200,000 fine," DeSombre points out. "Even if it is an account that has no interest payments or income tax obligation, you are still liable for the fine."

## A two-pronged approach

The legal challenge is part of a two-pronged "attack" on FATCA. On the legal side, Republicans Overseas will file a lawsuit to challenge the constitutionality of FATCA; on the legislative side, it will try to "repeal" FATCA through a bill that is likely to be part of an overall tax reform package.


"Given the impact of FATCA, we're spending a lot of time raising the issue with US politicians, especially among Republicans," DeSombre says. "They are generally in support of what we're doing. In fact, Senator Mike Lee (R-Utah) joined us for a trip to Paris, London, Luxembourg and Geneva to promote our anti-FATCA efforts and to raise funds for our cause."

"The lawsuit is actually complementary to our legislative effort because it makes it easier to gather support once people start seeing the process and understanding more about the issues," he says.

"Although we're pursuing this through the Republicans, it is really a bipartisan issue," he adds. "We truly believe supporting the effort to make a change is good for everybody."

"And, people shouldn't be turned off just because it's being done through one political party. It would be great if Democrats Abroad could join us in doing this exact same thing."

"These are obviously fundamental rights that are very important to every American," DeSombre says. "Through the lawsuit we are trying to serve a purpose in addressing issues that are not as well understood in US domestic politics but could affect the lives of millions of overseas Americans as well as some domestic Americans."

"There are after all some 7.6 million Americans living overseas in countries all over the world," he says. "Collectively, we would be the 13th largest state in the union based on population. That's a lot of people who are affected by some of the current US tax laws, including FATCA." 

## FATCA Statistics

*The Foreign Account Tax Compliance Act (FATCA) was enacted by Congress in 2010 as a way to target non-compliance by US taxpayers using foreign accounts. Here are some statistics and numbers related to FATCA's implementation.*

**30%** the taxes to be imposed on many overseas payments to financial institutions that don't share information with the IRS

**80,000+** the number of financial institutions that have registered with the US government

**80+** the number of countries the United States has reached final or provisional agreement with for streamlined information exchange, including the Cayman Islands and beginning discussions with China

**45,000** the number of US taxpayers who revealed offshore bank accounts through the IRS offshore voluntary disclosure programs (OVDP) since 2009

**\$6.5 billion** the amount of taxes, penalties and interest collected as a result of OVDP

**30** the number of banking professionals charged by the Department of Justice in offshore tax evasion matters from 2008 to April 2013

**60** the number of US taxpayers charged by the Department of Justice in offshore tax evasion matters from 2008 to April 2013

**2,999** the number of US citizens who renounced their citizenship in 2013, the highest number on record

Source: BostonTaxAttorneyBlog