Why FATCA may be repealed

Dr Angelo Venardos of Heritage Trust Group explains that Common Reporting Standards (CRS), the "son of FATCA", may get push back if FATCA is repealed in 2017.

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 (FFIs) worldwide to identify and report to the US all financial accounts owned by US citizens and Green Card holder, many American are facing an enormous challenge while living and working abroad amid an expanding regime of regulations, says Dr Angelo Venardos, chief executive officer of Heritage Trust Group.

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.

Every American who lives in London, Zurich, Singapore or Hong Kong, for example, needs to have a bank account simply because they need to be able to write cheques and pay utility bills just like anywhere else.

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. 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.

ANGELO VENARDOS
Heritage Trust Group

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 who are seeking to open a new account.

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 Asia, you are affected as long as you are American.

There are many affected people more than willing to fulfill their US tax obligations but are very concerned about getting something wrong in a tax filing.

price that Americans have to pay in terms of their freedom and privacy is in fact tremendous.

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 in the US or abroad, American citizens' freedom is recognized in the Constitution.

This is ultimately a bipartisan issue – whether one is a Democrat or Republican, one has the same concerns. 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.

"There are an increasing number of cases in which Americans are reportedly denied banking services."

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.

Conversely, in the US, the IRS must have reasonable cause and obtain a subpoena to be able to retrieve bank account information.

The increase in tax revenue expected from FATCA is relatively small, but, the

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. Republicans Overseas are 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. These are essentially treaties with foreign governments.

Before the US sign a treaty, America needs 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 violates 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 detail of financial information of every US citizen abroad to the IRS unconditionally, it is in reality seizure without probable cause or warrant.

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% withholding tax (to be imposed on FFIs for non-compliance) is not a tax but instead 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 one has a bank account with US$100,000 and it has been declared it for four years, one can be fined up to US$50,000 for every one of those four years and could theoretically end up getting a US$200,000 fine.

Even if it is an account that has no interest payments or income tax obligation, one is 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.

Rand Paul, the Kentucky senator and 2016 Republican presidential hopeful, is leading the effort to repeal FATCA. Senator Paul formally introduced legislation in March in the Senate to reverse the main requirements of FATCA, saying the law has wrongly deprived American ex-patriots of access to banking services, violated their privacy and forced many to renounce their citizenship.

The Senator first introduced legislation in 2013 to reverse the impact of FATCA, but it went nowhere in a Democratic-controlled Senate. With Republicans now in charge, he hopes to move the bill to the floor for a vote. It has no co-sponsors yet and was referred to the Senate Committee on Foreign Relations for initial review.

Whether the bill advances or not, it gives Senator Paul a forum to raise some of his favorite issues - tax fairness, privacy and government overreach - as he gears up his 2016 presidential bid.

The lawsuit is actually complementary to legislative efforts of Republicans Overseas because it makes it easier to gather support once people start seeing the process and understanding more about the issues.

FATCA AS A BIPARTISAN ISSUE

These are obviously fundamental rights that are very important to every American. Through the lawsuit the Republicans Overseas 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.

In 2014, 3415 renounced their American citizenship, up from the 231 who did so in 2008!

There are after all some 7.6 million Americans living overseas in countries all over the world.

Collectively, it's the 13th largest "state" in the union based on population.

"There are an increasing number of cases in which Americans are reportedly denied banking services."

FATCA statistics

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

80+ the number of countries the US has reached final of 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

30 the number of banking professionals charged by the Department of Justice in offshore tax evasion matters from 2008 to April 2003

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

OUTLOOK

Should FATCA be repealed, and the US takes it cards off the table, this leaves only the UK and EU to play with the "Son of FATCA". Common Reporting Standards (CRS) which are bilateral, not unilateral, and residency based, not citizenship driven, will most likely get push back.

So the horse may have bolted, but the pendulum may swing back to a healthy level playing field. ■