# Why FATCA is Bad for America – Update – H.R. 2847 - "Something Wicked This Way Comes" – Ray Bradbury – or in other words – "What a Country Will Do To Its Citizens When It Goes Bankrupt."

The Foreign Account Tax Compliance Act (FATCA) is having a negative impact on the U.S. economy, U.S. financial markets, American businesses operating abroad and American citizens who work and reside overseas.

American Citizens Abroad (ACA) is working hard to educate the legislature and decision makers to inform them of the many dangers of FATCA. Recently legislators and the media have come out in strong opposition to FATCA, some advocate for repeal, others for revisions of the regulations. All our unanimous that FATCA as currently drafted is bad for America and Americans.

## What is FATCA?

FATCA was initially introduced to target those who evade paying U.S. taxes by hiding assets in undisclosed foreign bank accounts. With such a noble goal, and with the strong backing of the Administration, Congress quickly drafted the FATCA legislation and quietly slipped it into the HIRE (Hiring Incentives to Restore Employment) bill signed into law by President Obama in March 2010. Most members of Congress are unaware of the unintended negative consequences this legislation will have when fully implemented in 2014.

## Key provisions of FATCA

FATCA requires foreign financial institutions (FFI) of broad scope - banks, stock brokers, hedge funds, pension funds, insurance companies, trusts - to report directly to the IRS all clients' accounts owned by U.S. Citizens and U.S. persons (Green Card holders).

Starting July 1, 2014, FATCA will require FFIs to provide annual reports to the Internal Revenue Service (IRS) on the name and address of each U.S. client, as well as the largest account balance in the year and total debits and credits of any account owned by a U.S. person.

If an institution does not comply, the U.S. will impose a 30% withholding tax on all its transactions concerning U.S. securities, including the proceeds of sale of securities.

In addition, FATCA requires any foreign company not listed on a stock exchange or any foreign partnership which has 10% U.S. ownership to report to the IRS the names and tax I.D. number (TIN) of any U.S. owner.

FATCA also requires U.S. citizens and green card holders who have foreign financial assets in excess of $50,000 (higher for those who are bona-fide residents abroad) to complete a new Form 8938 to be filed with the 1040 tax return, starting with fiscal year 2011.

## Those affected by FATCA

FATCA will have serious negative ramifications on the entire U.S. economy and more specifically on

• U.S. financial markets and financial institutions,

• U.S. businesses operating in global markets,

• American citizens residing overseas, and

• American citizens with legitimate investments overseas.

## The Dangerous Ramifications of FATCA

FATCA constitutes a breathtaking extension of U.S. legislative overreach, purporting to impose upon every foreign financial institution, corporation and partnership the obligation to examine whether and to what extent it must adhere to the application of U.S. law. In many cases, entities electing to comply with FACTA will find themselves in violation of local privacy laws. The cost for this massive reporting bureaucracy is estimated in the billions of dollars for foreign and U.S. financial institutions as well as for Americans residing overseas, not to mention for the IRS itself. Much more significant than the cost and time burden, FATCA creates a direct financial and legal threat to all foreign financial institutions.

After much complaint over the direct transfer of information from FFIs to the IRS, the Treasury Department created "Intergovernmental Agreements" or IGA's. This is a system intended to allow FFIs to release client account information via government to government exchange so that FFIs will not need to violate privacy laws by directly releasing information to the IRS. FFIs must still register with the IRS to abide by FATCA, whether or not the government signs an IGA, to avoid the 30% withholding. An anti-discriminatory clause has also been included in the IGA agreements in order to minimize the possibility of banking lock-out for U.S. citizens and U.S. persons. Nonetheless, U.S. citizens and U.S. persons continue to experience banking lock-out and reduction of services. Many FFIs have simply not referenced FATCA as the reason, citing only "private banking policy." Suddenly, after years of not calling into question banking policy, U.S. citizen clients are having their accounts closed, access limited, or being denied services all together. FATCA is definitely the cause. Those FFIs that do not enter into IGA are penalized with a 30% withholding tax on U.S. source investment income. A withholding tax on income transferred overseas, such as dividends and interest, is recognized as a fair and effective way of collecting taxes and is built into most double taxation treaties signed by the United States and other countries, generally with a reduced withholding rate. But FATCA provides in addition for a 30% withholding on the sale value of U.S. assetsand imposes the 30% withholding tax on ALL U.S. source transfers to non-compliant foreign financial institutions. This is completely different and is confiscatory. FATCA rests on a fallacy: guilty (of tax fraud) until proven innocent; this is a denial of justice as it is known in our Western world.

## Foreign divestment of U.S. investments is a serious risk

The FATCA threat of a 30% withholding tax and the potential exposure to transfer of personal data is inciting foreigners to divest out of U.S. securities and investments. Some foreign banks throughout the world have already indicated their intention to do so and have advised their institutional and private clients accordingly.

• The Japanese Bankers Association stated very clearly: In the event that the implementation of FATCA is not practically feasible for the Japanese financial services industry, it would result in substantial confusion in the industry and could ultimately lead Japanese financial institutions to withdraw their investment from U.S. financial assets. ii)

• The European Banking Federation and the Institute of International Bankers, which in their own words represent most of the non-U.S. banks and securities firms around the world that are affected by the FATCA provisions, highlighted their concerns: many FFIs, particularly smaller ones or those with minimal U.S. investments or U.S. customers, will opt out of U.S. securities rather than enter into a direct contractual agreement with a foreign tax authority (the IRS) that imposes substantial new obligations and the significant reputational, regulatory, and financial risks of potentially failing those obligations, or may disinvest their U.S. customers in order to reduce their compliance burdens under an FFI Agreement. iii)

• This warning from Europe was reiterated in June 2011. George Bock, a Luxembourg-based KPMG partner and head of tax at KPMG, told reporters at a funds event in London that FATCA could cause investors to sell out of U.S. stocks, bonds and other investments, affecting the price of U.S. shares as well as those of other countries in ways that are not yet fully clear. iv)

• KPMG conducted a survey in 2011 of leading fund promoters in 12 countries. v) The majority of respondents had assets under management in excess of EUR 10 billion, and more than half of the respondents distributed their shares/units in more than 10 countries. The survey asked: Further to FATCA, could your fund intend to disinvest (directly/indirectly) from the US? For both the U.S. fixed income market and the U.S. equity market, 6% answered yes. Another 10% for the fixed income market and 7% for the equity market stated that it was thinkable to divest from the U.S. A whopping 29% for the fixed income market and 26% for the equity market replied that divestment depended on the detailed implementation rules for FATCA. In other words, for funds managers worldwide, divestment from U.S. securities markets is a real option.

These statements must be taken seriously and should not be ignored. According to the U.S. Bureau of Economic Analysis, total foreign investment in the United States exceeds $21 trillion. vi) Foreign investment in U.S. securities alone exceeds $10 trillion. The capitalization of the two U.S. stock exchanges is $18.6 trillion. vii)

The financial weight of foreign financial institutions is enormous. The 100 Top Financial Institutions worldwide command total assets of $77.6 trillion. More than $55 trillion or two-thirds of this financial power is controlled by non-U.S. financial institutions. Among the top ten alone are seven non-U.S. financial institutions with combined balance sheet assets of $16.7 trillion. viii)

In addition to direct control of assets, foreign financial institutions have very significant client funds under management, funds which do not appear on their balance sheets. Among the top 15 Global Money Managers, 7 are non-U.S. financial institutions. The assets under management of just these 7 non-U.S. financial institutions are close to $9 trillion. ix)

These are big numbers. Foreign financial institutions have significant power through the allocation of their assets and this should be taken into account in a cost/benefit analysis of FATCA. x) The United States should not be playing with fire when it comes to keeping the country attractive for foreign investment.

## Risk of funds withdrawal from U.S. bank deposits held by non-resident aliens

In addition to investments in securities, foreigners hold over $1 trillion on bank deposit in the United States because those deposits are tax free and the United States represents a safe haven for non-resident aliens. Congress has deliberately established this policy to attract foreign funds so necessary to the U.S. economy. But if a 30% withholding tax may potentially be applied upon transfer of those deposits to an overseas account, the attractiveness of United States banking services disappears.

With the IGA currently being signed by foreign governments, the U.S. Treasury is promising reciprocity on information on foreigners holding financial assets in the United States. This is something the Treasury cannot and should not be promising. Already banks in Texas and Florida have protested that broad-based reciprocity will destroy their banking markets; many foreigners residing in Latin America have chosen banking in these states not to evade foreign taxes but for the anonymity and security provided, due to unstable governments inthe countries where they reside.

## The foreign direct investment component is also vulnerable

If future financial transfers out of the United States are perturbed by FATCA, the direct investment component of the U.S. economy may suffer as well. A pull back in foreign direct investment in the U.S., which now represents an accumulated $2.7 trillion, would negatively impact the growth of the economy. Attracting foreign companies to invest in the United States requires not only good business prospects but also a free flow of capital both into and out of the country. With the economy seriously underperforming, unemployment high and budget and trade deficits ballooning, this is not a time when the U.S. can afford to lose any kind of investment in its economy, but that is exactly what FATCA will provoke.

## The huge potential foreign investment losses largely outweigh FATCA revenues

Sale of just a portion of foreign holdings of U.S. securities, transfer of some of the foreign-owned bank deposits out of the United States and reduced foreign direct investment would severely damage the U.S. securities markets, the solvability of certain U.S. banks and the growth of the entire U.S. economy. The potential losses of trillions of dollars due to foreign institutions and foreigners divesting out of the United States totally outweigh the meager tax revenue that the IRS will actually collect as a direct result of this deeply flawed legislation. The Joint Committee

on Taxation (JCT) estimated that the FATCA bill would raise $792 million of additional taxes a year in the next ten years. xi) Congress never requested a full GAO (Government Accountability Office) cost/benefit study on FATCA. Administrative costs will be very burdensome and costly for the IRS, U.S. taxpayers and, most importantly, for financial institutions which despite a precarious situation in global financial markets, have no option but to spend hundreds of millions of dollars on compliance.

The U.S. financial industry is one of the nation's most competitive sectors in world markets today, and the open access and ability to freely transfer funds into and out of U.S. financial markets has historically been a key reason for that strength. This competitive position will be diminished by FATCA. The U.S. financial industry will find itself isolated from many international transactions. Foreign investors will avoid U.S.-based hedge funds. Foreign hedge funds will avoid investing in U.S. securities and will refuse U.S.