What Is the Foreign Account Tax Compliance Act (FATCA)?

The Foreign Account Tax Compliance Act (FATCA) is a tax law that compels U.S. citizens at home and abroad to file annual reports on any foreign account holdings. The FATCA was endorsed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act to promote transparency in the global financial services sector.

KEY TAKEAWAYS:

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FATCA was endorsed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act to promote transparency in the global financial services sector and to promote employment.

By taxing foreign-held assets, the United States planned to use the revenue stream to put toward job stimulation.

Penalties are imposed on U.S. residents who do not report their foreign account holdings and assets that exceed $50,000 in value in any given year.

Critics of FATCA claim that it places undue pressure on banks and financial institutions that are expected to report on the financial assets of their clients.

Understanding the Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA) was endorsed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act. HIRE was signed into law by President Barack Obama in 2010 to incentivize businesses to hire unemployed workers. Unemployment rates skyrocketed during the 2008 financial crisis.

One of the incentives offered to employers through the HIRE Act was an increase in the business tax credit for each new employee hired and retained for at least 52 weeks. Other incentives included payroll tax holiday benefits and an increase in the expense deduction limit for new equipment purchased in 2010.

FATCA seeks to eliminate tax evasion by American individuals and businesses that are investing, operating, and earning taxable income abroad. While it is not illegal to control an offshore account, failure to disclose the account is considered illegal since the United States taxes all income and assets of its citizens on a global scale.

To fund the costs of HIRE incentives, Congress included revenue-generating provisions in the HIRE Act through FATCA. FATCA provisions require all U.S. taxpayers to report all assets held outside of the country yearly. By taxing these foreign-held assets, the United States increases its revenue stream and puts the proceeds towards its incentive account for job stimulation. Penalties are imposed on U.S. residents who do not report their foreign account holdings and assets that exceed $50,000 in value in any given year.1

What Should be Reported Under the FATCA

Reporting requirements for the FATCA are far from straightforward. Specified foreign assets are difficult to define. According to Greenback Expat Tax Services, the Internal Revenue Service (IRS) defines the assets as:

Foreign pensions

Foreign stockholdings

Foreign partnership interests

Foreign financial accounts

Foreign mutual funds

Foreign issued life insurance

Foreign hedge funds

Foreign real estate held through a foreign entity (you don't need to report the real estate, but the foreign entity itself is a specified foreign financial asset, and its maximum value includes the value of the real estate)

Your foreign home does NOT need to be reported.2

Foreign Institution Compliance

Non-U.S. foreign financial institutions (FFI) and non-financial foreign entities (NFFE) are also required to comply with this law by disclosing the identities of U.S. citizens and the value of their assets held in their banks to the IRS or the FATCA Intergovernmental Agreement (IGA).

FFIs that do not comply with the IRS will be excluded from the U.S. market and also have 30% of the amount of any withholdable payment deducted and withheld from them as a tax penalty. Withholdable payments in this instance refer to income generated from U.S. financial assets held by these banks and include interest, dividends, remunerations, wages and salaries, compensations, periodic profits, etc.

FFIs and NFFEs that agree to the law must annually report the name, address, and tax identification number (TIN) of each account holder that meets the criteria of a U.S. citizen, the account number, the account balance, and any deposits and withdrawals on the account for the year.

Reporting Thresholds

The reporting thresholds for foreign assets vary based on whether you file a joint income tax return or live abroad. According to the IRS, "If you are single or file separately from your spouse, you must submit a Form 8938 if you have more than $200,000 of specified foreign financial assets at the end of the year and you live abroad; or more than $50,000, if you live in the United States. If you file jointly with your spouse, these thresholds double. You are considered to live abroad if you are a U.S. citizen whose tax home is in a foreign country and you have been present in a foreign country or countries for at least 330 days out of a consecutive 12-month period."3

The IRS requires Form 8938 for taxpayers living abroad under the following circumstances:

"You are married filing a joint income tax return, and the total value of your specified foreign financial assets is more than $400,000 on the last day of the tax year or more than $600,000 at any time during the year. These thresholds apply even if only one spouse resides abroad. Married individuals who file a joint income tax return for the tax year will file a single Form 8938 that reports all of the specified foreign financial assets in which either spouse has an interest.

You are not a married person filing a joint income tax return, and the total value of your specified foreign financial assets is more than $200,000 on the last day of the tax year or more than $300,000 at any time during the year."3

The IRS requires Form 8938 for taxpayers living in the United States under the following circumstances:

"You are unmarried, and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year.

You are married filing a joint income tax return, and the total value of your specified foreign financial assets is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.

You are married filing separate income tax returns, and the total value of your specified foreign financial assets is more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year. For purposes of calculating the value of your specified foreign financial assets in applying this threshold, include one-half the value of any specified foreign financial asset jointly owned with your spouse. However, report the entire value on Form 8938 if you are required to file Form 8938."3

Non-Compliance

If an entity does not file Form 8938, it may be subject to penalties. The IRS imposes a $10,000 failure to file penalty, an additional penalty of up to $50,000 if the guilty party continues to not file after IRS notification, and a 40% penalty for understating tax attributable to non-disclosed assets.3

The statute of limitations is extended to six years after an entity files their return for income over $5,000 that is not reported and is attributable to a specified foreign financial asset. Also, if a party fails to file or properly report an asset on Form 8938, the statute of limitations for the tax year is extended to three years beyond the time when the party provides the required information.

If there is a reasonable cause for the failure, the statute of limitations is extended only with regard to the item or items related to such failure and not for the entire tax return. No penalty is imposed if the failure to disclose is found to be reasonable, although this is decided on a case-by-case basis.3

Although the price to pay for not complying with FATCA is high, compliance costs are also high. Nigel Green, CEO of deVere Group and Co-Founder of the Campaign to Repeal FATCA estimated that 250,000 foreign financial institutions were being impacted by FATCA's reporting requirements. One Spanish bank stated that compliance costs could cost one of their local bank branches $8.5 million and a global financial institution $850 million. Estimates of the costs to U.K. financial institutions ranged from $1.1 billion to $1.9 billion.4

Criticism of the Foreign Account Tax Compliance Act (FATCA)

Of course, there are always critics of new tax laws. According to Reuters, FATCA drew the ire of banks and business people who called it "imperialist" and described it as “the neutron bomb of the global financial system.” Financial institutions objected to the fact that they were expected to report on their U.S. clients or withhold 30% of the interest, dividend, and investment payments due those clients and send the money to the IRS.5

Some critics argued that the cost of implementing FATCA would far outweigh the revenues raised by the U.S. Treasury.6

Tax lawyers at the Swiss-American Chamber of Commerce in Zurich argued that FACTCA would "deter foreign investment in U.S. securities and have a negative effect on U.S. companies that borrow money from foreign banks for strategic acquisitions."5

American Citizens Abroad proclaimed that Americans residing overseas need to have assets and bank accounts in their country of residence. If these Americans are subject to the Form 8938, this amounts to discrimination against Americans residing overseas because Americans residing in the United States are not required to report their assets for tax purposes. Only their income needs to be reported since federal taxes are levied only on income and capital gains.7

Overall, American Citizens Abroad was of the opinion that FACTA risked a potential loss of trillions of dollars of investment in the United States, the opportunity for American companies and financial institutions to compete in a global environment, and American citizens' ability to reside and thrive overseas.7