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What Multinational Families Need to Know About FATCA

By Joan K. Crain, CFP®, CTFA, TEP
Senior Director
Global Wealth Strategist

As part of the ongoing fight against global tax evasion, reporting requirements for U.S. persons living in the U.S. and abroad are becoming more wide ranging and complex. Enacted in response to the surprising revelation of the extent that U.S. taxpayers had been using accounts at Swiss banks to hide assets from the IRS, the Foreign Account Tax Compliance Act (FATCA) was arguably the first serious effort to combat tax evasion by U.S. persons. Despite initial challenges and efforts to undermine and even repeal the legislation, FATCA survived and led to similar programs by other countries. It is essential that multinational families understand the details of these requirements to ensure their compliance and avoid what can be steep penalties.

WHAT IS THE FOREIGN ACCOUNT TAX COMPLIANCE ACT?

FATCA was enacted by the U.S. Congress in 2010 with an effective date of July 1, 2014. In response to growing awareness of the number of U.S. persons evading taxes on their accounts and investments outside the U.S., FATCA provides the U.S. government with the necessary tools to effectively determine the ownership of foreign financial holdings belonging to U.S. persons. In doing so, it significantly increases the reporting responsibilities for both financial institutions and individuals associated with non-U.S. assets.

By attacking tax evasion on the dual fronts of service providers and owners of financial assets, FATCA sparked resentment and pushback from foreign countries, financial institutions and individuals with cross-border connections. Non-U.S. financial providers and jurisdictions noted the high costs of compliance and the fact that this reporting was in direct conflict with their countries' privacy rules. Two U.S. states — Florida and Texas — pursued litigation against the U.S. government, claiming this legislation would destroy their large international financial business. In addition, individual American citizens living in other countries have launched their own challenges based on abrogation of their civil rights.

However, the global importance of U.S. dollar-denominated investments has provided the U.S. with bargaining power. Further, as FATCA demonstrated the potential for significantly increased tax revenue, other developed countries have not only signed intergovernmental agreements for the reciprocal exchange of tax information with the U.S., but are now crafting their own sets of bilateral and multilateral tax information exchange agreements under the Common Reporting Standard (CRS).

THE IMPACT OF FATCA ON MULTIJURISDICTIONAL FAMILIES

The U.S. is proceeding swiftly with enforcement. What started as settlements with some of the large Swiss banks has grown to encompass a worldwide campaign to identify and prosecute U.S. tax evaders and the financial institutions and advisors who assist them. The Internal Revenue Service (IRS) and the U.S. Department of Justice (DOJ) now have access to thousands of records obtained under the nonprosecution agreements with Swiss banks, and are mining this data for evidence of non-compliant taxpayers.

It is now critical for multinational families to evaluate their possible reporting obligations. Penalties for FATCA non-compliance can be severe: up to $50,000 for failure to report, plus 40% on understated taxes, in addition to possible criminal or fraud penalties of up to 75% of the value of the undisclosed assets. On May 9, 2016, the DOJ concluded its first successful criminal prosecution of a U.S. person for violating FATCA reporting requirements. Gregg Mulholland, a dual U.S.-Canadian citizen, pleaded guilty to conspiring to violate FATCA reporting requirements through the use of offshore companies.[1] The era of hiding assets from the IRS by keeping them out of the U.S. is over.

1 Matthew D. Lee, "Justice Department's First FATCA Prosecution Yields Guilty Plea," Tax Controversy Watch, May 13, 2016, https://taxcontroversywatch.com/2016/05/13/justice-departments-first-fatca-prosecutionyields-guilty-plea/

Who Must Report?

Under FATCA, the term "U.S. persons" refers to a very broad class. It encompasses all American citizens and permanent residents of the U.S. (green card holders), including those who have lived abroad for many years, even if they have no intention of returning to live in the U.S. In addition, people who have had a "substantial presence" in the U.S. and those who have elected to be classified as U.S. taxpayers are also subject to FATCA reporting requirements. Further, U.S. entities such as trusts, partnerships and corporations must also report their offshore financial holdings.

What Must Be Reported?

Under FATCA, U.S. persons must report foreign financial assets totaling $50,000 or more at year-end ($100,000 if married and filing jointly) or at least $75,000 at any time during the past year ($150,000 if married and filing jointly). The thresholds are higher for U.S. persons living outside the U.S.: foreign financial assets totaling $200,000 or more at year-end ($400,000 if married and filing jointly) or at least $300,000 at any time during the past year ($600,000 if married and filing jointly).

For FATCA purposes, the classification of foreign financial assets is also wide-ranging. In general, a U.S. person must report all non-U.S. assets for which the income, credits, distributions or deductions would be included on his or her U.S. income tax return. This extends far beyond foreign bank and investment accounts, to include less obvious assets such as the cash value of foreign life insurance contracts and interests in some foreign trusts. Tangible property, foreign currency, precious metals and real estate are not reportable under FATCA. However, if these are held in a foreign entity, such as a foreign corporation, the interests in that entity are reportable assets.

Much of the information on the "FATCA Form" (IRS Form 8938) is duplicative of that required on other forms. This causes confusion, particularly with the other well-known "foreign asset" report, FinCEN Form 114, more commonly known as the FBAR. With a foreign asset threshold of just $10,000, the FBAR requires disclosure of many of the same items as the Form 8938, but with some important differences, including which assets to report, the filing deadline and classes of required filers. For some of the several overlapping forms, reference to another form is sufficient. In other cases, the actual accounts and assets must be specifically listed on more than one form.

REGULARIZING REPORTING OBLIGATIONS

For a number of years, the U.S. Treasury has offered a series of amnesty programs designed to incentivize U.S. persons with unreported foreign accounts and income to voluntarily resolve their delinquencies. Early Offshore Voluntary Disclosure Programs (OVDP) featured maximum penalties ranging from 5% to 20% of unreported assets. Subsequent versions of the OVDP featured increasing penalties, currently rising to more than 50% if the institution or advisor who the taxpayer worked with is already involved in an investigation by the U.S. government.

Following sharp attacks by the Taxpayer Advocate in 2012 for harsh treatment of innocent persons, the IRS offers a streamlined procedure aimed at taxpayers who certify that their non-compliance was "non-willful." Designed for people who were not intentionally hiding assets offshore, this process provides for maximum penalties of 5% for U.S. residents and no penalty for non-residents. However, it provides no guarantee that the IRS or the DOJ won't later launch an investigation, particularly if the government receives new information indicating the person was deliberately concealing offshore assets.

By mid-2018, the IRS reported that it had collected over $10 billion. Clearly the U.S. government considers these amnesty programs successful. Despite the penalties and paperwork, the OVDP and streamlined procedure provide straightforward ways for taxpayers to regularize their affairs. However, the long running OVDP ended on September 28, 2018 and was replaced by an amnesty program that is less predictable and potentially more severe for taxpayers without good explanations for their delinquencies. In light of comments, such as the following announcement by IRS Commissioner John Koskinen, U.S. persons with undeclared foreign income or assets would be well advised to take advantage of these programs now:

"As we continue to receive more information on foreign accounts, people's ability to avoid detection becomes harder and harder... The IRS continues to urge those people with international tax issues to come forward to meet their tax obligations."[2]

[2] IR 2016-137, United States Tax Reporter, ¶72,014.15; TG ¶71869

FATCA, CRS AND GLOBAL TRANSPARENCY

What started as a U.S. initiative to combat tax evasion by U.S. persons has grown to a global assault — not only on tax avoidance, but also on money laundering and, according to some, privacy. FATCA predates the CRS, but FATCA enforcement has been gradual, allowing financial institutions and jurisdictions grace periods to come into compliance. Implementation of the CRS has been faster, with early adopter countries starting their reporting in 2017. Although the process of signing reciprocal agreements between countries will play out over time,108 countries have committed to exchange information by 2020.

While FATCA and the CRS share similar objectives, there are significant differences in the scope and processes. This has led to uncertainty at many levels of the financial system, which in turn, has translated into confusion and difficulties for families with cross-border connections.

Comparing a few of the provisions in the two major approaches provides insight regarding the dilemmas facing financial institutions and the global families they serve. While both programs require similar reporting of clients' personal and financial data, the CRS requires several additional pieces of information. Further, and even more importantly, unlike FATCA the CRS has no minimum threshold and requires more extensive reporting on beneficiaries and other deemed "controlling persons" of certain kinds of trusts. So a family with financial assets in both the U.S. and in other member countries of the Organisation for Economic Cooperation and Development (OECD) may experience repeated requests from their financial providers, seeking more pieces of information. Some of these inquiries may seem unnecessary and even intrusive.

In addition, burdened by the regulations necessary to serve cross-border clients, some financial institutions have refused to provide new financial services and have even closed accounts of "foreigners" in their country. This appears to affect U.S. persons in particular, because FATCA imposes withholding duties and potential penalties on financial institutions. Since the announcement of FATCA, Americans living abroad have reported that they are experiencing difficulties accessing financial services in some jurisdictions.

As the trend for global transparency continues, governments, financial providers and global families alike are experiencing the unintended consequences as well as the benefits.

ABOUT THE AUTHOR

Joan K. Crain, CFP®, CTFA, TEP
Senior Director, Global Wealth Strategist

As a senior director and global wealth strategist, Joan works closely with families and their advisors to provide comprehensive wealth planning. She specializes in multinational planning, business succession, family governance and philanthropy. With more than 25 years of experience working with large, multi-generational families, she is frequently invited to speak to client and professional groups such as the American Bar Association, the American Institute of CPAs, STEP and numerous estate planning councils. Her unique style is highly interactive, emphasizing real- life examples and practical tools. Joan is a frequently quoted fiduciary and family governance expert and author of articles in business publications, including The Wall Street Journal, the New York Times, Trust and Estates magazine and Barrons. In addition, she is past Chair of the Board of Directors of the Community Foundation of Broward and she serves on the Executive Committee of the Florida Bankers Trust Division. Joan earned a master of business administration from Rollins College, a bachelor of education from Queens University and a bachelor of music from McGill University. She is a Certified Financial Planner™ professional and has earned the designation of Certified Trust and Financial Advisor from the American Bankers Association and Trust and Estate Practitioner from the Society of Trust and Estate Practitioners (STEP), the premier international wealth planning organization.