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The Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA), enacted as part of the Hiring Incentives to Restore Employment Act (HIRE Act, P.L. 111-147), was intended to increase compliance with U.S. tax law among U.S. citizens and residents with financial holdings outside the United States. FATCA aimed to reduce noncompliance by requiring certain U.S. taxpayers with assets outside the United States to report those assets to the Internal Revenue Service (IRS) and placing requirements on foreign financial institutions (FFIs).

Under FATCA, FFIs and certain other entities are required to report foreign assets held by U.S. account holders to the IRS on Form 8966, FATCA Report. FFIs can register directly with the IRS or comply with the FATCA Intergovernmental Agreement (IGA) for their jurisdiction (if applicable). The United States currently has FATCA IGAs with 113 countries. FFIs that do not comply with FATCA may face 30% withholding on their U.S.-source income.

FATCA disclosures generally require an FFI to obtain consent from its account holder to share the holder's financial information. If consent is not granted from the account holder, FFIs must withhold and remit to the IRS 30% of any U.S.-source income generated by these accounts.

Under FATCA, certain U.S. taxpayers holding financial assets offshore greater than certain thresholds must report those assets to the IRS on Form 8938, Statement of Specified Foreign Financial Assets. The specific thresholds depend on residence and marital status. The threshold for taxpayers residing in the United States is $100,000 on the last day of the tax year or $150,000 at any time during the tax year for those filing married joint returns and $50,000 (or $75,000) for all other taxpayers. Taxpayers living abroad have thresholds of $400,000 (or $600,000) for those filing married joint returns and $200,000 (or $300,000) for all other taxpayers. The threshold for certain domestic entities is $75,000.

Failure to report foreign financial assets on Form 8938 may result in a penalty of $10,000 (and a penalty up to $50,000 for continued failure after IRS notification). Further, underpayments of tax attributable to nondisclosed foreign financial assets are subject to an additional substantial understatement penalty of 40%.

The Organisation for Economic Co-operation and Development (OECD) subsequently implemented a multilateral program similar to FATCA, the Common Reporting Standard (CRS). CRS provides for reciprocal information sharing. More than 100 countries have adopted the CRS, but the United States has not.

Effectiveness in Inducing Compliance

The magnitude of individual tax evasion is uncertain, but recent estimates placed it at around $40 billion a year (see CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle). When enacted, FATCA was projected by the Joint Committee on Taxation to raise $1 billion in revenues per year by 2019, which is a small share of current estimates of international tax evasion.

Reporting requirements for FFIs on accounts held by U.S. taxpayers can increase compliance by providing third-party reporting and can increase revenue through data to identify noncompliant individuals, imposing a withholding tax, and encouraging voluntary compliance. The implementation of FATCA by the IRS had been delayed, in part, by the need to set up agreements with other countries, where domestic law does not permit the sharing of information, to arrange IGAs where FFIs report to their governments, which in turn report to the IRS. The IRS compliance program has also been delayed by resource constraints and, most recently, the coronavirus pandemic.

A 2022 report by the Treasury Inspector General for Tax Administration (TIGTA) also highlighted difficulties with obtaining taxpayer identification numbers (TINs) from FFIs, the failure to institute matching, in part for that reason, and the lack of focus on nonfilers of Form 8938. TIGTA reports that the IRS appears to be moving toward identifying nonfilers, although it is hindered by the lack of data on TINs. In 2019, according to the TIGTA report, FFIs identified 1,286,866 unique individual TINS, while the number of Form 8938 individual filings was 467,145. However, this difference may be due to the fact that the filing threshold is higher for married couples for the Form 8938 than for the Form 8966.

The TIGTA report indicates withholding of $536 million in 2018, and $8 million of penalties for underreporting. IRS stresses that the purpose of FATCA is not withholding or penalties but to encourage voluntary compliance. The effectiveness of FATCA is difficult to measure. In its response to TIGTA, the IRS noted the substantial increase in filings of Foreign Bank and Financial Account (FBAR) forms that are filed with another agency, the Financial Crimes Enforcement Network (FinCEN). Form 8938 reports have increased from 307,004 in 2014 to 467,145 in 2019. A study by Ahrens and Bothner estimated that FATCA and CRS together reduced evasion by 67%, but did not determine the separate effects of FATCA. A study of FATCA by de Simone, Lester, and Markle found that it reduced investment into the United States from tax havens during 2012-2015 by 21%.

Reciprocity, Joining the CRS

Unlike CRS, FATCA does not have full reciprocity in information sharing. The IRS receives more information on U.S. owners of foreign accounts than other countries receive on foreign owners of U.S. accounts. Legislation would be required to authorize the collection of the data needed for full reciprocity, including account balances and beneficial owners. (Legislation has already been adopted to disclose beneficial owners of certain entities, including corporations and limited liability companies: the Corporate Transparency Act, P.L. 116-283, although it has not been fully implemented.) The failure of the United States to reciprocate under FATCA has been criticized by the European Union. In some views, the failure of the United States to share information under FATCA makes it one of the major secrecy jurisdictions in the world.

The Administration's FY2023 budget includes a proposal to provide full reciprocity. If reciprocity is not adopted, other countries have the option of imposing withholding taxes on payments to U.S. financial institutions.

Another option is for the United States to join the CRS, which would replace FATCA. Such a change would eliminate requirements for multiple reporting under the two systems for banks, but certain issues, such as reporting for U.S. citizens abroad, would need to be clarified, since the U.S. tax applies to all citizens regardless of residence.

FATCA and Americans Living Abroad

The U.S. tax system is largely based on citizenship—where U.S. citizens are taxed on their worldwide income regardless of where they reside. According to the U.S. Department of State, nearly 9 million U.S. citizens lived abroad in 2020. Although FATCA did not change the underlying tax rules for Americans living abroad, it did increase awareness of those obligations and added reporting requirements for FFIs that they may utilize.

One concern related to FATCA is its effect on access to financial services for U.S. citizens living abroad. In a 2019 report, the Government Accountability Office (GAO) found evidence that U.S. citizens living abroad faced reduced access to financial services as FFIs revaluated the risks and benefits of having U.S. citizens as clients. In response to these concerns, Treasury allowed certain low-risk FFIs to be deemed FATCA compliant if they did not restrict access to financial services for U.S. citizens. Although anecdotal evidence persists that reduced access to financial services remains a concern, FFIs' concerns should be mitigated as FATCA compliance issues become better understood and the adoption of CRS becomes more widespread.

H.R. 5799 (Maloney) would exempt FFIs from reporting requirements under FATCA for U.S. citizens who are residents in the FFI's country. Residents, as defined in the bill, are U.S. citizens residing in an FFI's country at least 330 full days during the prior 12 consecutive months.

A second FATCA concern of Americans living abroad is compliance costs. These costs include the time spent collecting, organizing, and filing IRS forms and any costs paid for professional assistance. In various annual reports to Congress, the National Taxpayer Advocate has offered recommendations to reduce FATCA compliance costs by (1) harmonizing requirements with FBAR, and (2) exempting from FATCA accounts held in the country in which a U.S. citizen is a bona fide resident.

A further concern related to FATCA is that it may impact individuals who are U.S. citizens as a result of being born in the United States or by having a parent who is a U.S. citizen, but have otherwise little to no tie to the United States. These individuals may not even be aware of their U.S. citizenship unless notified by an FFI of their need to comply with FATCA or if denied entry to the United States with a non-U.S. passport. As a result, these individuals are sometimes referred to as accidental dual citizens. Accidental dual citizens are subject to the same FATCA requirements as other U.S. citizens. Due to their tenuous ties to the United States, accidental dual citizens may be more likely to renounce their U.S. citizenship than other groupings of U.S. citizens living abroad, though costs associated with renouncing U.S. citizenship may be considered prohibitive. The European Union Parliament has stated its position that being subject to FATCA is not justified for these individuals.

The President's FY2016 budget would have removed accidental dual citizens from taxation as U.S. citizens if they met certain requirements. The current FY2023 budget proposes a narrow exemption from certain exit taxes for lower-income dual citizens. Another option to address this concern would be to allow a path for accidental dual citizens to renounce their U.S. citizenship though a streamlined process.

Jane G. Gravelle, Senior Specialist in Economic Policy
Donald J. Marples, Specialist in Public Finance

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