taxnotes® international

Volume 83, Number 9 ■ August 29, 2016

How FATCA and CRS Affect U.S. Investment

by William Ahern and Josh Maxwell

Reprinted from *Tax Notes Int'l*, August 29, 2016, p. 783

(C) Tax Analysts 2016. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

(C) Tax Analysts 2016. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

FEATURED PERSPECTIVE

How FATCA and CRS Affect U.S. Investment

by William Ahern and Josh Maxwell

William Ahern is a principal with Ahern Lawyers in Hong Kong, and Josh Maxwell is a partner with Hone Maxwell LLP in San Diego, California.

In this article, the authors compare the automatic exchange of tax information under the U.S. Foreign Account Tax Compliance Act and the common reporting standard and examine the effects both systems have on international finance centers.

In this article, we compare the automatic exchange of tax information under the U.S. Foreign Account Tax Compliance Act and the common reporting standard (CRS), which many practitioners think is merely a type of global FATCA. However, the CRS is far more complicated; intrusive on privacy rights; and burdensome, especially for fiduciaries.

We also examine the potential impact (intended or otherwise) that both the CRS and FATCA have on international finance centers.

FATCA

FATCA was designed to catch U.S. taxpayers evading U.S. taxes by hiding money in foreign banks. Instead of relying on taxpayers' honesty, it went to what the IRS saw as the crux of the problem: foreign banks. Using the power of its economy (with its global reserve currency and as home to more than half the value of global equity markets), the United States forced foreign banks to report to the IRS U.S. taxpayers with accounts held personally or through entities they ultimately owned.

The big stick is a 30 percent withholding tax penalty on banks that fail to sign up for FATCA or play by the rules. Only the United States has the leverage to wield such a stick, and it works.

FATCA's main targets are the ultimate custodians of assets (banks, asset managers, and so forth); however, intermediaries such as trustees who report through them can also get caught in FATCA's reporting web. FATCA looks through holding entities to find U.S. persons who are reportable and doesn't require as many details on those entities. It is not interested in tax residence — only U.S. taxability status — because the United States is one of only two countries that taxes based on citizenship rather than residency.

FATCA's brilliance is its effective outsourcing of the IRS's enforcement function to foreign banks. To be FATCA compliant, foreign financial institutions must ensure proper reporting of account holders. Vague promises of reciprocity in FATCA — that is, the United States will report foreigners in its own banking system — seem distant and less than sincere.

CRS

The CRS, although broadly modeled on the FATCA concept of outsourcing tax enforcement to foreign asset managers, differs in important respects. It is based on full reciprocity of all who agree to exchange data. Through a series of multilateral and bilateral treaties between 100 or more nations (of varying degrees of governance and rule of law standards), it allows for the exchange of vast quantities of sensitive financial data of those who bank outside those nations. Therefore, the scope for loss and abuse of resultant data pools is enormous.

The CRS both compels the ultimate foreign asset custodians to report financial data and imposes either alternative or additional reporting requirements on a range of intermediates and trustees in ownership chains. And unlike FATCA, it often compels the reporting of nonfinancial assets.

The CRS requires reporting on details of the pot of gold at the end of the ownership rainbow — that is, the assets (with which FATCA is concerned) — as well

For more *Tax Notes International* content, please visit www.taxnotes.com.

as on details of the ownership structures themselves. Moreover, it requires reporting of not only the ultimate owners of the assets but also the ultimate owners of entities that don't own anything — for example, trustee or protector companies.

The CRS is concerned with tax residence, a more nebulous concept than a U.S. person. It imposes no withholding penalty, instead relying on reciprocity and penalties in each implementing country as well as the threat of licensing withdrawals for defaulting banks and other intermediaries.

The CRS is far less prescriptive than FATCA in defining both its obligations and who has them. That reduced certainty makes it harder to comply with.

Consequences, Intended or Unintended

FATCA encourages U.S. taxpayers to be tax compliant and to bank domestically, whether they are compliant (to avoid the reporting hassle) or noncompliant (to avoid discovery). Its compliance burdens discourage non-U.S. banks from taking on U.S. customers, making FATCA good for the IRS, U.S. banks, and the U.S. economy in general.

As far as the United States is concerned, there is not even a pretense of reciprocity in the CRS as there is in FATCA. It has not signed on to the CRS and is unlikely to in the near future. That giant CRS loophole will undoubtedly drive assets to U.S. banks and other U.S.-based intermediates.

Therefore, both FATCA and the CRS favor the IRS over other national revenue agencies, U.S. banks and other intermediaries over their non-U.S. counterparts, and the U.S. economy over the rest of the world.

The United States hardly needs the CRS when FATCA is already working for it. It might be (rightly) concerned about the safety of information it would dispatch to many other countries. However, a cynic might suggest that favoring U.S. banks and the U.S. economy — which flows from the decision to impose FATCA unilaterally while abstaining from the CRS — is no accident. ◆

COMING ATTRACTIONS

A look ahead to upcoming commentary and analysis.

The EU anti-tax-avoidance directive (*Tax Notes International*)

Sandy Bhogal discusses the EU anti-tax-avoidance directive and the ways in which it overlaps with the recommendations in the OECD's base erosion and profit-shifting project.

In defense of water's-edge reporting (*Tax Notes International*)

Todd Roberts and Joel Walters discuss recent changes by many U.S. states to their water's-edge reporting rules and the potential consequences of those changes.

The default regime for partnership adjustments: Stranger than it might first appear (*Tax Notes*)

Kate Kraus analyzes the new partnership rules enacted in the Bipartisan Budget Act and discerns that sometimes the default regime is the only one that applies.

Selecting transfer pricing comparables after *Medtronic* (*Tax Notes*)

Robert Feinschreiber and Margaret Kent discuss the importance of industrial standards in choosing comparables for transfer pricing after *Medtronic*.

Using taxes to improve cap and trade, part II: Efficient pricing (*State Tax Notes*)

David Gamage and Darien Shanske propose how to reform state-level cap-and-trade regimes.

State Tax Notes celebrates its 25th anniversary with a special issue featuring articles from Billy Hamilton, Peter Faber, Arthur Rosen, Lynn Gandhi, Kathleen Wright, William Weissman, Timothy Noonan, Walter Hellerstein, and John Swain.

(C) Tax Analysts 2016. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

For more *Tax Notes International* content, please visit www.taxnotes.com.