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Improving FATCA: Three Key Areas

By Keith Lawson

Congress enacted the [Foreign Account Tax Compliance Act \(FATCA\)](#) in 2010 in response to efforts by certain U.S. taxpayers to hide assets and income subject to U.S. tax. To enhance tax compliance by U.S. taxpayers, FATCA imposes significant new customer identification, reporting, and withholding obligations on both U.S. and foreign financial institutions. Any foreign financial institution that fails to attain FATCA compliance will suffer 30 percent withholding tax on all payments from U.S. sources, including income receipts and sales proceeds.

The U.S. Department of the Treasury and the Internal Revenue Service (IRS) have made significant progress in addressing industry concerns with FATCA. The IRS released [proposed FATCA regulations](#) in February. In a recent comment letter, [ICI](#) offered a range of ways to improve those rules so that FATCA's tax compliance benefits—which ICI supports—won't be outweighed by undue costs and negative impacts for funds and their investors. Let's focus on three key areas where we've made recommendations.

Ensuring That FATCA Does Not Disadvantage U.S. Funds Seeking Foreign Investors

- **Problem:** Under the proposed FATCA regulations, payments of any kind that are attributable to a U.S. fund will be subject to 30 percent FATCA withholding when paid to investors who lack proper documentation. This occurs because all amounts paid by U.S. funds are treated as having a U.S. source, even if the fund invests only outside the United States. As a result, FATCA puts U.S. funds seeking foreign investors at a distinct competitive disadvantage. How so? Principally, foreign financial institutions distributing both U.S. and non-U.S. funds that invest outside the United States may encourage foreign investors to invest in non-U.S. funds to avoid facing FATCA withholding if their documentation is deemed faulty. FATCA concerns might lead to this recommendation even when the comparable U.S. fund has lower fees, better performance, or both.
- **Solution:** U.S. funds should be allowed to impose withholding only on the portion of payments equal to the percentage of U.S.-source income or assets in the portfolio. For example, an electing fund that invested only in non-U.S. securities and received income only from these non-U.S. securities would not make any U.S.-source payment subject to FATCA withholding.

Taking a More Workable Approach for Retirement Plans

- **Problem:** The proposed regulations take some steps to exempt retirement plans from FATCA obligations. Still, many plans—including Australian superannuation funds and Hong Kong mandatory provident funds—cannot satisfy the current exemption requirements. Without a solution, FATCA's requirements could force these funds to take measures, such as closing accounts, that are illegal under their home country's laws.
- **Solution:** The FATCA rules should state that retirement plans organized under a country's retirement plan laws will be certified as FATCA compliant, except to the extent provided by the Treasury secretary. In other words, should the Treasury have concerns that a particular type of plan is being used for tax evasion, it can address those concerns on a case-by-case basis.

Easing the Burden of Customer Identification Without Compromising Tax Compliance

- **Problem:** FATCA imposes upon financial institutions very substantial obligations to collect and examine documentary evidence

to support investor certifications of their status as compliant. Some obligations will take effect on January 1, 2013—before institutions have had time to incorporate new IRS forms and regulations, which are not yet final, into their processes.

- **Solution:** The rules should be revised to ease this burden in ways that do not compromise FATCA objectives. Financial institutions, for example, should not be required to “re-document” foreign investors every three years, unless the institution has information indicating that the investor has become a U.S. taxpayer. Providing more time before institutions are required to implement still-to-be-issued guidance likewise would reduce administrative burdens and enhance appropriately targeted tax compliance.

As regulators work on FATCA, ICI will continue to provide input from the viewpoint of industry and investors. For more on FATCA, see the [Viewpoints](#) post on ICI Global's recent [FATCA letter](#).

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