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Cracking Down on Tax Evaders Without Cracking Up U.S. Capital Markets

By Keith Lawson

The Foreign Account Tax Compliance Act (FATCA) is a law designed to ensure that U.S. persons holding assets through accounts in foreign financial institutions comply with their U.S. tax obligations. In other words, the law aims to crack down on tax evasion through offshore investments. It is set to apply to payments made beginning January 1, 2013.

How FATCA gets implemented could have serious implications for both ICI members and U.S. capital markets, as we discussed in a [recent letter](#) to the Department of the Treasury and the Internal Revenue Service. Our letter discusses a range of steps that regulators should take to make FATCA more effective and easier to administer.

FATCA effectively requires foreign financial institutions (FFIs) with U.S. investments or other U.S. connections to enter into agreements with the IRS. Each FFI must report the income that its U.S. clients earn through the FFI, and must impose 30 percent withholding on investors who do not provide appropriate documentation regarding their status as U.S. or foreign.

ICI's FATCA interest arises largely from concerns raised by foreign institutions that FATCA is unduly burdensome. If these concerns are not addressed adequately, these firms might decide not to offer funds managed by U.S. firms or to exit the U.S. securities markets altogether.

One possible outcome is that FFIs would encourage investors to choose non-U.S. funds over U.S. funds to avoid possible FATCA withholding should investors fail to provide appropriate documentation. Concerns about FATCA might lead to this recommendation even when a U.S. fund has lower fees and better performance.

We propose that regulators address this concern by providing U.S. funds with an option to determine the portion of their payments subject to the FATCA withholding regime based on the portion of their assets attributable to U.S. sources. Under the IRS Notices issued so far, a U.S. fund is treated as 100 percent U.S.-sourced simply because the fund is organized in the U.S.

Another area where we offered suggestions regards the impact of FATCA on retirement plans and accounts. We suggest guidelines that would allow more foreign retirement plans to be classified as posing a low risk of tax evasion. Few such plans have earned that qualification under current rules, even though foreign retirement plans and accounts provide Americans with little, if any, opportunity for hiding assets and evading taxes.

On these and other FATCA provisions, we look forward to working with regulators to make sure the law can achieve its objectives in the most administrable manner.

- Read ICI's [letter](#).
- Learn more about ICI's work on [tax policy](#).
- Read ICI's [Frequently Asked Questions About Taxation for Mutual Fund Investors](#).
- Browse more [recent ICI comment letters](#).

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