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LEADING THE WAY

US fat cats in fear of Fatca, but other Americans abroad need not worry

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A new US law called the Foreign Account Tax Compliance Act (Fatca) has recently caused a stir because it forces foreign financial institutions (FFIs) worldwide to comply with US demands.

The outrage includes cries of violation of sovereignty, the fear of foreign citizens being taxed by the US government and a grumbling about how this complicates banking significantly. But before we throw our beloved green tea into the Mekong River in a re-enactment of the Boston Tea Party, read on and discover what Fatca is and how it may affect our lives.

Fatca has its origins in the US taxation system. A "US person" is taxed on his or her worldwide income by the Internal Revenue Service (IRS), the US tax authority. For an individual, the term "US person" includes US citizens and residents.

Those with dual citizenship are also classed as a US person if one of the two components is US citizenship.

Both Thailand and the US may then tax the income earned in Thailand by a US person, although this rarely results in an actual tax payment to the IRS on foreign income, as there are provisions to prevent double taxation.

The IRS then relies on the US financial institution (USFI) to collect and share information on who is being paid what. However, when a payment is made to a foreign account, the USFI and IRS often do not know who the ultimate recipient of that income is.

Up until now, the US has been able to bring financially important countries and territories such as Britain, Hong Kong and Singapore into an information-sharing agreement, but these are too few to be effective for worldwide tax enforcement.

Fatca negates the need for the US to negotiate a complex agreement with each country by putting power directly in the hands of the USFI. It empowers the USFI to withhold 30% from withholdable payments to FFIs unless the FFIs reveal the name and tax status of the receiving account holder.

To avoid withholding, FFIs must continue to agree to conduct due diligence and annually report the name, balance and aggregate payments of accounts held by a US person to the IRS.

For an individual, the increased due diligence will amount to answering one simple question: are you a US person? If you refuse to answer that, the participating FFI will be forced by Fatca to treat your account as "recalcitrant" and withhold 30% from withholdable payments.

Your account may also be closed because an FFI may not want the extra burden associated with a recalcitrant account. But if you answer, then your payment will never be withheld under Fatca regardless of whether you are a US person. Fatca was designed to collect information, not tax.

There are two tiers of information sharing — with the USFI and with the IRS. First and foremost, the FFIs must share the name of every recipient of withholdable payments with the paying USFI. Second, FFIs must report account information to the IRS but only of accounts held by a US person.

That means Thai citizens' names will be known to the USFI and possibly the IRS but only if they are a recipient of US-sourced withholdable payments. Their account information will not be reported to the IRS.

Therefore, if you are Thai and have no investment in US assets, you are likely to remain anonymous to the IRS.

But if you are a US person, then information of your accounts in Thailand will be reported to the IRS, and you should be aware of the tax implication that follows. While Fatca stipulates you must complete Form W-9 with an FFI, the real battle is your tax return filing with the IRS.

Regardless of Fatca, a US person is obligated to file an annual US tax return and must also report any foreign account with a balance greater than US$10,000 under the Report of Foreign Bank and Financial Accounts (FBAR) provision.

Fatca supplements the IRS's ability to verify these filings — for example, account information reported by FFIs under Fatca and by the taxpayer under the FBAR could be compared for consistency. The IRS may also be able to target a US person who has reported insignificant foreign earnings but somehow received significant payments in his or her foreign account, as reported by FFIs.

If you are a US person but not familiar with the US tax return or the FBAR filings, then this may be a good time to seek the advice of a US tax professional. This is especially true if you have a large income or have a high net worth.

US legislators possibly were not kidding when they chose the acronym Fatca as a warning to the wealthy US fat cats living abroad.

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