U.S. – Swiss Tax and Regulatory Issues

What is FATCA?

The Foreign Account Tax Compliance Act (FATCA), passed by the U.S. Congress in March 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, is a "new development in U.S. efforts to combat tax evasion by U.S. persons holding investments in offshore accounts," according to the **website of the IRS**.

As the IRS explains, "[under] FATCA, U.S. taxpayers holding financial assets outside the United States must report those assets to the IRS on a new form attached to their tax return. Reporting is required in taxable years beginning on or after January 1, 2011."

In addition, according to the IRS, "FATCA will require foreign financial institutions to report directly to the IRS certain information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. This new reporting regime applies with respect to payments made by foreign financial institutions to covered accounts on or after January 1, 2013."

FATCA is taking a new approach to combating tax evasion by targeting visible foreign entities rather than their hidden U.S. customers. By doing so, the act is expected to collect $8.5 billion in U.S. tax revenues over 10 years. The repeal of tax benefits for foreign-marketed bearer bonds and a 30 percent withholding tax on interest would garner $3.1 billion alone. These figures, however, are relatively low and a small increase in the cost of U.S. capital could outweigh the increase in tax revenue.

The Law: The HIRE Act

FATCA was included as an "offset provision" in the Hiring Incentives to Restore Employment (HIRE) Act, enacted in March of 2010 to increase employment during the recession. The bill "provides tax benefits to employees who hire previously unemployed workers, subsidizes construction bonds, and helps fund highway and other transit programs," according to a summary on opencongress.com.

Employers who hired previously unemployed workers ("qualified employees") were given a payroll tax exemption that excused employers from the 6.2 percent share of social security tax on wages paid from

March 19, 2010 through December 31, 2010. Businesses were also eligible for a tax credit, referred to as the new hire retention credit, which refunded 6.2 percent of wages, up to $1,000, that were paid to the qualified employee over 52 consecutive weeks.

The Consequences and Controversy

While the requirement that U.S. persons report their overseas investments on a new tax form is not controversial, the requirement that foreign financial institutions submit information about their clients' accounts to the IRS is causing great difficulties for financial institutions across the world. Many financial institutions are struggling to find ways to implement the new IRS requirement without violating their countries' client privilege and privacy laws, and some have declared that they will no longer provide services to any U.S. citizens. Others describe the cost of compliance to their and other institutions as many times the amount of additional tax revenue the IRS can hope to receive. These costs, of course, will be borne by the economy at large. (For more information on this position, see the **Swiss-American Chamber of Commerce website**).

Challenges of Implementation

The regulations pose a challenge to the banking industry, which must identify, document, and classify all existing client relationships. The classifications of natural persons in the banking system will require little effort, but other relationships lack sufficient codes for automated classification. The regulations of FATCA include eight different classifications for legal accounts and the adaptation of IT systems to accommodate these classifications will be very costly.

Consequences for Financial Service Providers in Switzerland

In addition to the costs of IT adaptation, foreign financial intermediaries (FFI), which include foreign banks, financial institutions, and securities traders, must cope with an increase in the cost of ongoing operations. FFIs are required to collect data on U.S. accounts, report this information in the format stated by the IRS, and then correctly declare the withholding tax within a set timeframe.

Swiss FFIs must conduct a cost-benefit analysis and determine whether signing FATCA is worth the cost of compliance. Banks with few U.S. foreign investments may decide not to sign the agreement and forgo doing business with the U.S. They risk losing clients to banks that have signed the agreement. On the other hand, banks that sign FATCA risk that some clients will leave the institution to do business with a bank that has not signed FATCA.

Consequences for Business Outside the Financial sector

If a business receives income from American sources or earns a profit by selling American securities though an American paying agent or FFI, the business must confirm that it is not held by U.S. investors that hold a 10 percent share. If this cannot be proven, the company must provide the American paying agent or FFI with the information and taxpayer identification number or every U.S. investor, which will be reported to the IRS. If this information is not provided or is incorrect, the American paying agent or FFI is required to withhold taxes at 30 percent on all U.S. payments and revenues. Publicly-traded enterprises and related group associations are exempt. The IRS has also mentioned other exemptions, such as foreign holding companies holding active investments outside of the finance sector, newly-founded companies, and intra-company financial companies outside of the finance sector.

Impact on Americans Living Abroad

According to American Citizens Abroad (ACA), FATCA will negatively affect American citizens living overseas by limiting access to banking facilities abroad. Because the cost of reporting information to the IRS is so high and the process so cumbersome, many foreign institutions are no longer providing banking services to Americans. These institutions are closing current accounts or refusing to open new accounts, including simple accounts used on a day to day basis. At the same time, U.S. banks are citing the *"Know Your Client"* rules of the Patriot Act to deny services to U.S. citizens abroad. In response, American citizens may find that they must bank with a non-qualified FFI, an FFI that has not accepted FATCA and does not invest in U.S. securities. Others may deny that they are U.S. citizens to prevent qualified FFIs that comply with FATCA from closing their accounts. (To read more about negative impacts on Americans and other consequences, please see the **ACA website**).

Effects on Investment Behavior within the U.S.

Financial institutions that are unwilling or unable to meet the new legal requirements have the option not to sign FATCA and will have to terminate all U.S. client relationships and investments.

Trustees are considered FFIs so they must accept FATCA obligations or let go of all U.S. investments and mandates.

Investment funds must also comply with FATCA regulations, which will be a challenge because the investment of one U.S. citizen creates a fund that acts as a U.S. person itself. This raises the concern of structural assurance over time, but without FATCA these funds will lose U.S. investments.

FATCA also affects insurance providers. Life insurers that have policies with payments from pension or annuity payments must comply with FATCA regulation, which will harm foreign insurance providers.

Employer-financed pension funds are not affected by FATCA, but all pension investment entities not financed by the employer must comply with FATCA rules.

Contributed by Lauren Bishop

Further Reading:

Text of the Act, see *Title V – Offset Provisions*

Internal Revenue Service (IRS)

Opencongress.org

Swiss-American Chamber of Commerce

“Foreign Account Tax Compliance Act aims to close individual tax gap” by Kimberly Tan Majure

***Why FATCA is Bad for America and Why it Should be Repealed*, position paper by American Citizens Abroad**

“FATCA Law is an International Version of Obamacare’s 1099 Provision, a Nightmare for Cross-Border Economic Activity that Is Undermining Investment in America” by Dan Mitchell

Open Letter from Senators Rand Paul, Jim DeMint, Mike Lee, Saxby Chambliss to Secretary of the Treasury Timothy Geitner regarding FATCA