Overview of FATCA

by S. Bruce Hiran


S. Bruce Hiran

S. Bruce Hiran recently received his LLM in taxation from the University of Houston Law Center.

In this article, Hiran highlights the burdens that the Foreign Account Tax Compliance Act imposes on taxpayers and financial institutions, and he suggests that if the goal is simply to raise revenue, a federal sales tax would be a better alternative with fewer negative effects.

This article was selected as a winning entry in Tax Analysts' annual student writing competition.

The IRS's efforts to enforce the Foreign Account Tax Compliance Act will increase tax revenue from Americans living abroad. As a byproduct, many expect a reduction in enforcement efforts toward taxpayers living in the United States. Because of this and other complications of FATCA, the United States should consider alternative options for raising revenue, namely consumption taxes such as a VAT, federal sales tax, or federal internet tax.

A. The Current Income Tax System

The average American taxpayer's risk of being audited by the IRS has dropped by 23 percent since 2013. This is in line with reductions in the IRS budget, which has fallen by an inflation-adjusted rate of 17 to 20 percent since 2010. Only 0.9 percent of individual taxpayers were audited in 2013, the lowest proportion in seven years. Wealthier individuals face more scrutiny than average taxpayers. A person who makes $200,000 to $1 million annually has about a 2.2 percent chance of audit, more than double the overall average. The rate is even higher for the ultrawealthy: Those who earn more than $1 million annually are audited at a rate of around 7.5 percent. However, those rates are dropping dramatically. The only taxpayers who saw an increase in their chances of being audited last year were those living overseas. Fewer audits mean less tax revenue, in both the short and long term. In 2013 IRS audits uncovered $11.9 billion in unpaid taxes, 15 percent less than the year before. Fewer audits in 2014 could also mean more cheating in future years. Studies show that taxpayers who have been through an audit report more taxable income in future years. The IRS has estimated that budget cuts cost the government at least $2 billion in revenue each year.[1] It is believed that the treasury has been losing more than $100 billion annually as a result of offshore tax noncompliance.[2]

As reflected above, the current income tax system is not meeting the revenue needs of our nation. An alternative solution may be a combination of an income tax and a consumption tax.

The 16th Amendment gave the federal government the power to impose an income tax. Our tax laws, including FATCA, authorize the IRS to tax U.S. citizens and resident aliens on their worldwide income regardless of where they are living.

Under the Haig-Simons theory of income, income equals consumption plus change of net worth. That model is targeted at individual workers. Because it requires the taxpayers themselves to record their consumption, track their net worth, and report what they owe, the model is intrusive and therefore fraught with many collection and enforcement problems. Further, the income tax law is too complicated for effective and efficient collection of taxes from ordinary taxpayers. The complexity of the system entails record-keeping costs, the payment of tax professionals to prepare returns, and, in some cases, the payment of significant fees to tax fraud defense attorneys.

In the long run, the United States loses because the amount the IRS spends on enforcement and collection brings in barely enough tax revenue to pay for those enforcement and collection costs. Accordingly, federal revenue will be $2.8 billion to $3.5 billion short (not collected) for the fiscal year, meaning that the net loss in revenue because of the 2015 IRS budget cut will be approximately $1.2 billion to $1.7 billion or more.

Because of the current budget constraints, law-abiding taxpayers will be unable to receive the assistance they need when they contact the IRS with legitimate questions and requests for help.

---

[1] Ben Steverman, "The IRS Has New Favorite People to Audit," Bloomberg Business, Apr. 9, 2015.

[2] 111 *Cong. Rec.* S1635-S1636.

Also, the complicated tax code allows some taxpayers — those with the financial ability to hire tax and financial professionals — to exploit loopholes to avoid the payment of what may otherwise be legitimate taxes. This results in a patently unfair manipulation of the tax system by the affluent and penalizes those who lack that financial ability.

Unfortunately, gaps in the tax system allow affluent taxpayers to pursue risky investments (for fun and leisure), stimulating the growth of a multibillion-dollar industry to cater to them and help them write off the associated expenditures.

Further, the current system encourages the wealthy to dodge taxes by borrowing money for investments. Because people with the financial ability can borrow the sums needed for their investment ventures and write off the interest on those loans, they are able to defer any gain from the venture in the short run. Allowing persons with means to write off the interest associated with their loans is inequitable and penalizes those of lesser means who do not have access to onshore or offshore capital.

B. History and Purpose of FATCA

FATCA is a federal law that requires American citizens, including individuals who live outside the United States, to report their financial accounts held outside the United States. It also requires global foreign financial institutions to search their records for residents who are suspected of being U.S. nationals and report those individuals' assets and identities to Treasury.[3]

The background to the enactment of FATCA is the ongoing budget crisis the United States has faced, including having a deficit every year for nearly 16 years. Federal expenditures have outpaced the IRS's ability to collect sufficient revenue to pay for the federal budget.

How should the U.S. government design its tax system to collect revenue from U.S. citizens and business entities overseas in an effective and efficient way? More specifically, how do we shut down international tax loopholes and shelters and thereby increase both reporting and tax revenues? In the past, various criminal organizations, among others, have benefited from those international tax hideouts. On the other hand, the Justice Department and the IRS have focused on preventing and closing those loopholes and collecting taxes more effectively and efficiently from those who maintain financial interests offshore.

On March 18, 2010, as a part of the Hiring Incentives to Restore Employment (HIRE) Act,[4] President Obama signed FATCA into law to help the Justice Department and the IRS collect tax revenue more effectively and efficiently. FATCA's main objective is to reduce tax evasion by U.S. individuals and specific entities regarding financial assets held outside the United States. FATCA requires or induces FFIs to report to the IRS the U.S. citizens who hold financial accounts in those institutions. One of FATCA's enforcement tools is a 30 percent U.S. withholding tax on specific payments to FFIs, which include banks, brokers, custodians, and investment funds.

C. FATCA Legislative Intent and Finalization

Over the past few decades, the Justice Department and the IRS have targeted international tax evasion and tax fraud prosecution of potential taxpayers through the examination of foreign or offshore banking or financial institutions. For example, they would investigate a U.S. taxpayer using an offshore bank account in a country that has complex bank secrecy laws suitable for hiding the existence and ownership of the account, thus enabling the taxable income that is in the account to go undetected and unreported. During their pursuit of evaders, the Justice Department and the IRS uncovered webs of complex cross-border tax evasion and tax fraud networks that concealed the existence of foreign banking and investment accounts by reporting foreign sham transactions. The IRS and the Justice Department were more limited in their ability to discover those shams than if the transactions had occurred in the United States or in countries with fewer bank secrecy laws.

The Justice Department and the IRS would sometimes discover a U.S. taxpayer's shell game of manipulating the complex foreign tax deferral regimes for foreign corporations controlled by layers of wealthy U.S. citizens and sham business entities. The usual shell game involves a business entity controlling a trust in a Caribbean country. Typically, the trust would own shares of a sham business entity in a Southeast Asian country that owns and controls multiple large manufacturing facilities in China. Those sham entities would then own banking and investment accounts with very large sums of money in Switzerland, Cyprus, or the Cayman Islands.

The IRS has the authority to collect taxes on U.S. citizens, U.S. resident aliens, and U.S. business entities on their worldwide income regardless of where they live or the source of their income. U.S.

[3]Andrew C. Liazos and Todd A. Solomon, "What You Need to Know About FATCA's Impact on Non-U.S. Retirement Plans," McDermott Will & Emery (Mar. 21, 2013).

[4]P.L. 111-147.

citizens are individuals born in the United States or its territories, including U.S. embassies abroad. U.S. resident aliens are defined as persons lawfully admitted as permanent residents (green card holders) and aliens who meet the substantial presence test of section 7701(b)(3). In general, substantial presence is defined as being physically present in the United States for at least 31 days during the current calendar year, if the weighted average of days present in the United States during the current and prior two calendar years exceeds 183 days. One of the factors in determining physical presence is whether the person has been in the United States for 121 days on average each calendar year and purposely avoided classification as a resident alien to escape tax liability on his worldwide income. It is plain to see that this has been and is a problem for the IRS because of the difficulty in enforcement against individuals who operate offshore and try to manipulate not only the location of their assets but also their classification. Many special interest groups have been pushing for a residence-based tax system. The problem with those systems is that tax revenue would likely decline.[5]

D. Timeline for FATCA Enforcement

FATCA is generally considered to be effective as of January 1, 2013. The Justice Department and the IRS, under FATCA, have started to require institutions to report changes to account-opening and investor on-boarding procedures for new accounts. U.S. financial institutions (USFIs) are required to treat any account opened on or after January 1, 2013, as a new account. FFIs that enter into an FFI agreement with the IRS (called participating FFIs or PFFIs) are required to treat any account opened after July 1, 2013 (or the effective date of the FFI agreement, if later), as a new account. Accounts opened before those dates are treated as preexisting accounts, which are subject to less stringent documentation and due diligence requirements than new accounts. The IRS procedures for the review of PFFIs' preexisting accounts are required to be completed in stages, with high-value accounts and accounts held by entities that are obviously FFIs requiring a detailed review within one year and other preexisting accounts requiring review within two years.

U.S. citizens living abroad face a number of tax compliance burdens not faced by their fellow citizens residing in the United States. The requirements of FATCA force the U.S. citizens living abroad to file complex yearly tax returns that include foreign currency transactions, foreign tax credits, and excess housing cost exclusions. They are also forced to file at least one foreign income tax return or foreigner tax return, and more documentation will likely be required by the banking and investment institutions in their foreign countries.

E. FATCA and FFI Reporting Relationship

The IRS under FATCA requires USFIs to obtain FATCA documentation for all preexisting obvious FFI accounts by December 31, 2013, and all other preexisting entity accounts no later than December 31, 2014. The IRS tax withholding provisions of FATCA first came into effect on January 1, 2014, when specific U.S.-source income payments became subject to FATCA withholding. Gross proceeds from the sale of a U.S. security became subject to FATCA withholding as of January 1, 2015. Withholding by FFIs on foreign passthrough payments has been delayed and will not be required before January 1, 2017.

The IRS started accepting applications for FFI agreements beginning January 1, 2013. The effective date of an FFI agreement is July 1, 2013, for agreements entered into on or before that date. Agreements entered into after July 1, 2013, become effective on the date of signing. For most FFIs under the purview of FATCA, the FFI must have entered into an FFI agreement no later than June 30, 2013, to prevent the imposition of FATCA withholding on income payments received on or after January 1, 2014. Any FFI that entered into an FFI agreement after June 30, 2013, may not be identified as a participating FFI in time to prevent withholding.

Many countries have suggested that FATCA infringes upon their international economic rights. Regardless, FATCA reporting for PFFIs was first required to be filed in September 2014 (for 2013 activity) and will be less detailed for 2014 activity. The reporting for future years will be more detailed, according to FATCA requirements.

F. Withholding From Non-U.S. Investment Funds

Under FATCA, investment funds outside the United States are treated as FFIs. FATCA will enforce the 30 percent withholding on all "withholdable payments" and "foreign pass-through payments" that those funds receive unless they sign an agreement to become PFFIs with the IRS or establish their qualifications for one of the very narrow categories of FFIs that are deemed compliant or exempt from FATCA. Further, the IRS will try to make it very difficult to maintain PFFI status by using tight due diligence reviews of investors and enforcing strict compliance with FATCA withholding and reporting requirements. This is similar to FFIs jumping off a cliff while being handcuffed and

[5]Robert W. Wood, "More People — And Now Companies — Exit U.S. Taxes," *Forbes*, July 30, 2014.

blindfolded. Many FFIs are questioning the legitimacy of the IRS's extraterritorial exercise of jurisdiction.

G. Conflict With Many Countries' Privacy Laws

Early on, many countries expressed that FATCA reporting rules requiring FFIs to report account holder information to the IRS are indirectly in conflict with and, in application, directly raise serious issues with their data protection and privacy laws. Further, many countries' laws may not permit the withholding that compliant FFIs may have to impose on payments to their noncompliant account holders or investors. The conflict of laws between FATCA and many countries applying to FFIs has been the subject of global criticisms on the enforcement of extraterritorial law by the ''bully U.S. DOJ and IRS.''[6] To help change that perception, the IRS announced that it is exploring other options, such as an intergovernmental approach to FATCA implementation and reduction of the high compliance costs and complex requirements imposed on FFIs.

One approach is the so-called Model 1 intergovernmental agreement, which will allow FFIs of countries such as France, Germany, Italy, Spain, and the United Kingdom to report to their local tax office instead of the IRS, thereby eliminating potential conflicts with local privacy or data protection laws. Further, FFIs in those countries may be relieved from imposing withholding on passthrough payments to their recalcitrant account holders and to other FFIs organized in FATCA partner countries. Under specific guidelines, the FFIs in those countries may be excused from withholding obligations regarding nonparticipating FFIs in non-FATCA partner jurisdictions. The second example, the Model 2 IGA, which was introduced on June 21, 2012, is a hybrid between Model 1 and FATCA's original reporting requirements. Under the Model 2 IGA, FFIs in Switzerland and Japan will report to their local tax office and report limited information to the IRS. Their local tax office will then supplement the FFI's reporting to the IRS upon request by the IRS, the Justice Department, or other U.S. governmental entity. FFIs in FATCA partner countries will likely be obligated to perform due diligence to identify potential U.S. account holders.

How the complex and strict due diligence requirements should be interpreted is still unclear to most of the partner countries. Only time will tell if the due diligence procedure will be tolerated.

[6]Julius Melnetzer, ''Canada-U.S. Dual Citizens Could Be Worse Off if FATCA Lawsuit Succeeds,'' *Financial Post*, Aug. 18, 2014.

H. The Complexity of Enforcement

FATCA is claimed to be an intrusive and complex law. The requirements for PFFIs to withhold on passthrough payments to noncompliant account holders or investors may cause those PFFIs to lose customers and investors. FATCA requires that any withholdable payment (or other payments to the extent attributable to a foreign withholdable payment) must be reported and the 30 percent withholding enforcement must be applied. For example, an investor or investment fund created and organized under Thailand's law — but that involves U.S. persons or entities within the purview of FATCA — is now classified as an FFI. When it pays a dividend, it must report the dividend to the IRS under FATCA regardless of the source of the dividend income. Further, the IRS may have access to the names and identities of those who are not U.S. persons within the purview of FATCA by the mere fact that they are partners in the entity. Consequently, business entities in many countries have chosen to exclude U.S. persons as partners.

I. Major Effects of FATCA

Many tax professionals and tax scholars have expressed that FATCA will have major effects on financial institutions worldwide. Thus, an international, multidisciplinary, professional task force should be organized to identify the effects FATCA will have on those who are subject to it. It is important to evaluate FATCA's impact not only on U.S. persons and entities in foreign countries but also on foreign persons and entities with operations or ties to the United States or U.S. taxpayers. Another concern is how FATCA will change the systems and operations in collection and evaluation of banking and investment account information, withholding, and reporting. Even though FATCA regulations have not been finalized and proposed regulations are subject to change following a public comment period, it is critical that the banking and investment industry discuss and exchange the compliance strategies globally. FATCA compliance costs fall mostly on FFIs and foreign governments because the regime enlists FFIs to enforce its reporting regulations. As a result, U.S. banking and investment institutions are now beginning to feel the backlash from their foreign counterparts.

J. Purview of FATCA

U.S. persons who own foreign accounts or other specified financial assets must report their information on IRS Form 8938, ''Statement of Specified Foreign Financial Assets,'' and submit it with their U.S. tax return if the accounts are worth more than a threshold amount. The threshold is increased for U.S. persons who are overseas residents and joint filers. There is a 40 percent penalty on understatements of income in an undisclosed foreign financial asset. The IRS requires FFIs to enter into an agreement to disclose the names and identities of their U.S. person account holders, as well as specific financial information. U.S. persons or business entities that make payments to noncompliant FFIs are required to withhold 30 percent of the gross payments and are not permitted a credit or refund on withheld taxes absent a treaty override. The definition of FFI is very broad and encompasses entities that would not typically be considered financial institutions, such as private equity funds, hedge funds, venture capital funds, specific family investment vehicles, and other similar investment funds. The exceptions are investment funds and banking institutions wholly owned and controlled by foreign sovereigns.

K. Controversy

Some aspects of FATCA have been sources of controversy in the financial and general press.[7]

1. Cost. Although figures are speculative, estimates of the additional revenue raised seem to be heavily outweighed by the cost of implementing FATCA. The Association of Certified Financial Crime Specialists (ACFCS) states that FATCA is expected to raise approximately $800 million per year for the U.S. treasury, but some claim that the costs of implementation will far outweigh the revenue, even without factoring in the additional cost to the IRS for the staffing and resources needed to process the data.[8] Unusually, FATCA was not subjected to a cost-benefit analysis by the House Ways and Means Committee. Perhaps not considered by Congress, the cost to global financial institutions to implement FATCA could be more than $200 billion, based on per capita costs already computed for Australia and the United Kingdom.[9]

2. Benefit versus cost. The rationale for identifying U.S. persons and their non-U.S. financial accounts would be to increase tax revenue from the interest, dividends, and gain on previously undisclosed assets. Most of the assets discovered will be standard checking and savings accounts for which the applicable interest is less than 0.5 percent (during 2015). Most of that income is already attributable to the country where it resides. Another projected source of revenue is in the identification of a wider population of U.S. persons living abroad. However, because of tax treaties, the majority — at least 82 percent — of those expatriates will owe no income tax to the United States.[10]

3. Capital flight. The primary mechanism for enforcing compliance of FFIs is a punitive withholding levy on U.S. assets. This may create a strong incentive for FFIs to divest any U.S. assets they hold or to simply invest elsewhere, resulting in capital flight.[11] When enacting FATCA, Congress did not publish the source of the revenue data and, as mentioned above, did not perform a cost-benefit analysis.

4. Foreign relations. Forcing FFIs and foreign governments to collect information on U.S. citizens at their own expense and transmit it to the IRS has been called ''divisive.''[12] Canada's former Finance Minister Jim Flaherty raised an issue of ''far-reaching and extraterritorial implications'' that would require Canadian banks to become extensions of the IRS and would jeopardize Canadians' privacy rights. There are also reports of foreign banks refusing to open accounts for Americans, making it harder for Americans to live and work abroad.[13]

5. Extraterritoriality. FATCA enables U.S. authorities to impose regulatory costs and, potentially, penalties on FFIs that otherwise have few dealings with the United States. To ameliorate that criticism, the United States has offered reciprocity to countries that sign IGAs, but the idea of the United States providing information on its citizens to foreign governments has proved controversial.[14] The law's interference in the relationship between individual Americans or dual nationals and non-U.S. banks has led the eminent international business consultant Georges Ugeux to describe FATCA as ''bullying and selfish.''[15] *The Economist* has called FATCA's extraterritoriality ''stunning by even Washington's standards.''[16]

---

[7]Colleen Graffy, ''How to Lose Friends, Citizens, and Influence,'' *The Wall Street Journal*, July 17, 2013.

[8]Brian Kindle, ''FATCA May Identify Tax Cheats, But Its Dragnet for Financial Criminals May Produce an Even Bigger Yield,'' Association of Certified Financial Crime Specialists (Mar. 1, 2012).

[9]Mark Twain, ''#FATCA Global Implementation Costs Revealed,'' The Isaac Brock Society (Oct. 20, 2014).

[10]''Residence-Based Taxation: A Necessary and Urgent Tax Reform,'' American Citizens Abroad (Mar. 2013).

[11]''Scratched by the FATCA,'' *The Economist*, Nov. 26, 2011.

[12]''Why FATCA Is Bad for America and Why It Should Be Repealed Now!'' American Citizens Abroad (July 2011).

[13]Bill Hinchberger, ''European Banks Shut Americans Out Over U.S. Tax Rules,'' *USA Today*, Sep. 27, 2012; and Sophia Yan, ''Banks Lock Out Americans Over New Tax Law,'' CNN Money (Hong Kong), Sep. 15, 2013.

[14]Letter from Rep. Bill Posey, R-Fla., to Treasury Secretary Jacob Lew (July 1, 2013).

[15]Lynnley Browning, ''Complying With U.S. Tax Evasion Law Is Vexing Foreign Banks,'' *The New York Times*, Sep. 16, 2013.

[16]''Taxing America's Diaspora: FATCA's Flaws,'' *The Economist*, June 28, 2014.

6. Citizenship renunciations. *Time* magazine reported a sevenfold increase in Americans renouncing U.S. citizenship between 2008 and 2011, attributing this at least in part to FATCA.[17] According to *BBC News Magazine*, FATCA is one of the reasons for that surge in the renunciation of American citizenship — a rise from 189 people in the second quarter of 2012 to 1,131 in the second quarter of 2013.[18] Another surge in renunciations was reported in 2013, with FATCA again cited as a major factor.[19] According to Andrew Mitchel, an international tax attorney, the number of Americans giving up U.S. citizenship started to increase dramatically in 2010 and rose to 2,999 in 2013, almost six times the average level of the previous decade.[20] The trend continued in 2014 with more than 2,300 people giving up citizenship in the first three quarters of the year. The numbers of those who are renouncing their citizenship are understated considerably.[21] Many more Americans may be considering it, according to a survey reported by *Forbes* magazine, which said that "5.5 million Americans eye giving up U.S. citizenship."[22]

7. American citizens living abroad. According to the Canadian Broadcasting System, Americans living abroad may face large fines as a result of FATCA.[23] *Time* magazine reports that many American citizens living abroad are now unable to open foreign bank accounts.[24] *The Wall Street Journal* reports that "FATCA worsens the already profoundly unjust tax treatment of middle class Americans living abroad. . . . FATCA rules were intended to correct a tax loophole. Applied to Americans living abroad, they are absurd."[25] *The Guardian* reports that Americans living abroad feel financially terrorized by FATCA requirements.[26] According to research conducted by Democrats Abroad, "these survey results show the intense impact FATCA is having on overseas Americans. Their financial accounts are being closed, their relationships with their non-American spouses are under strain, some Americans are being denied promotions or partnership in business because of FATCA reporting requirements, and some are planning or contemplating renouncing their U.S. citizenship."[27]

Here are 10 facts we know about FATCA:

1. FATCA blew in on a perfect storm. It grew out of the controversial rule that the United States taxes its citizens and permanent residents on their worldwide income regardless of where they live.

2. Everyone around the world has agreed to comply. More than 80 countries have agreed to the law, and more than 77,000 financial institutions have signed on. Even tax havens have joined up. Consequently, the IRS has a searchable list of financial institutions.

3. China and Russia have agreed to FATCA.

4. FATCA is America's big stick. The threat of its 30 percent tax and the threat of exclusion from U.S. markets are so potentially catastrophic that everyone has opted to comply. FFIs must withhold the 30 percent tax on noncompliant account holders.

5. Everyone is on the lookout for American indicia. FFIs must report account numbers, balances, names, addresses, and U.S. tax identification numbers.

6. Foreign bank account reports are still required. FBAR predates FATCA and is really a duplicate reporting requirement. FATCA just adds to the burden, including Form 8938, but does not replace FBARs.

7. FATCA compels compliance. U.S. account holders who are not compliant have limited time to report to the IRS. The IRS recently changed its offshore voluntary disclosure program to make it a little harsher: The penalty was increased in August 2014 from 27.5 percent of the highest account balance to 50 percent.

---

[17] Helena Bachmann, "Mister Taxman: Why Some Americans Working Abroad Are Ditching Their Citizenship," *Time*, Jan. 31, 2013.

[18] Tom Geoghegan, "Why Are Americans Giving Up Their Citizenship?" BBC News, Sep. 27, 2013.

[19] Laura Saunders and Liam Pleven, "Overseas Americans: Time to Say 'Bye' to Uncle Sam?" *The Wall Street Journal*, Aug. 17, 2013.

[20] Mitchel, "2013 Expatriations Increase by 221 Percent," International Tax Blog (Feb. 6, 2014).

[21] Wood, "Record Numbers Renounce U.S. Citizenship — And Many Aren't Counted," *Forbes*, July 30, 2014; and Eric, "The Federal Register: Timeliness, Date of Filing, and Date of Publication," The Isaac Brock Society (July 29, 2014).

[22] Wood, "5.5 Million Americans Eye Giving Up U.S. Citizenship, Survey Reveals," *Forbes*, Oct. 27, 2014.

[23] Amber Hildebrandt, "U.S. FATCA Tax Law Catches Unsuspecting Canadians in Its Crosshairs," CBC News (Jan. 13, 2014).

[24] Bachmann, *supra* note 17.

[25] David Kuenzi, "American Expats' Tax Nightmare," *The Wall Street Journal*, July 9, 2014.

[26] "'I Was Terrified We'd Lose All Our Money': Banks Tell U.S. Customers They Won't Work With Americans," *The Guardian*, Sep. 24, 2014.

[27] Tricia Moon, "Democrats Abroad Publishes FATCA Research — 'FATCA: Affecting Everyday Americans Every Day,'" The Isaac Brock Society (Sep. 15, 2014).

8. Banking will never be the same. FATCA is making banking transparent worldwide. The IRS now has faster access to better and more complete information than it ever has.

9. Forget repeal or dismantling of FATCA. Republicans oppose it, but there is no serious push to repeal it.

10. Don't count on other passports. Some dual nationals and green card holders think they can bypass FATCA by using a non-U.S. passport and non-U.S. address with their foreign bank. Not true. Doing so may just make the situation worse by handing the IRS the badge of willfulness and the opportunity to claim fraud once it is discovered.[28] Under FATCA, U.S. government officials will seek out U.S. persons who willingly and intentionally avoid compliance, and the result may very likely be civil and, potentially, criminal penalties.

L. Consumption Tax as a Supplement to FATCA

There are several arguments for using a consumption tax to augment the current tax system until FATCA is more effective:

1. A consumption tax system will help in raising revenue when people spend their money.

2. It encourages savings; people who under the current tax system make expensive purchases and write off business entertainment would reduce spending on those items, in favor of saving.[29]

3. People put savings into the economy.

4. Income equals savings minus consumption (I = S - C).

5. Savings provide jobs and wages, which reduces unemployment.

6. When people withdraw their savings to spend on consumption, they pay tax on that spending.

7. A consumption tax is simpler to enforce than FATCA and other aspects of the tax system.

   a. People are familiar with a form of consumption tax (sales tax).

   b. Congress could enact a program similar to Texas's sales tax. States could add a percentage on top of their sales tax and turn the revenue over to the IRS.

M. Federal Retail Sales Tax as an Alternative

In early 1942, during President Franklin D. Roosevelt's administration, a federal retail sales tax was considered. It was decided that it would not work.[30] Back then, the world economies were much different. Soon after World War II, the United States became the only nation in the world with a prosperous economy. It is not that way now.[31]

In late 1944 Congress did not want a federal retail sales tax because it preferred the employment withholding system. Congress also believed that the war — and war expenditures — would soon come to an end.

A federal online sales tax could also bring in tax revenue. The National Conference of State Legislatures estimates that the United States lost more than $23.3 billion in tax revenue in 2012 from uncollected sales tax on online transactions, according to its most recent estimate.

N. Difficult Hurdles Await FATCA

1. IRS not ready. According to *The New York Times*, it is unclear whether the IRS can handle millions of complicated filings each year.[32] On May 2, 2014, the IRS issued Notice 2014-33, 2014-21 IRB 1033, announcing a transition period in enforcement and administration in 2014 and 2015 for entity investors but not for individual investors.[33]

2. Complexity. Many have expressed doubts about the workability of FATCA because of its complexity.[34] The congressional time schedule for putting it into effect has been delayed twice.[35]

3. Identity theft. The IRS has reported that identity thieves are sending fraudulent compliance requests and demands as a phishing scam to get sensitive account holder information.[36]

4. Marketability of U.S. financial products. In the European Parliament's Economic and Monetary Affairs Committee public hearing on FATCA on

---

[28] Melnetzer, *supra* note 6.

[29] C. Joseph Bankman and Thomas Griffith, "Social Welfare and the Rate Structure: A New Look at Progressive Taxation," 75(6) *Cal. L. Rev.* 1905 (1987).

[30] Lawrence A. Zelenak, "The Federal Retail Sales Tax That Wasn't: An Actual History and an Alternate History," 73 *Law & Contemp. Probs.* 149 (2010).

[31] White House, "Leveling the Playing Field: Curbing Tax Havens and Removing Tax Incentives for Shifting Jobs Overseas" (May 4, 2009).

[32] David Jolly and Brian Knowlton, "Law to Find Tax Evaders Denounced," *The New York Times*, Dec. 26, 2011.

[33] Robert Loewy, "Foreign Account Tax Compliance Act (FATCA) Transitional Relief and Extension of Time for the Implementation of New Account Procedures for Entity Investors," *The National Law Review*, May 9, 2014.

[34] Frederic Alain Behrens, Comment, "Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand," 2013(1) *Wis. L. Rev.* 205 (2013).

[35] Anthony Parent, "Oh Great, Now There Is a FATCA ID Scam Too," Parent & Parent LLP (Sep. 24, 2014).

[36] European Parliament FATCA Hearing (May 29, 2013).

May 29, 2013, Robert Stack, Treasury deputy assistant secretary (international tax affairs), said, ''I believe the . . . members here present today and the participants understand that the United States . . . put its markets at risk in doing FATCA.''[37]

O. Conclusion

While it is appropriate and commendable to attempt to close loopholes and enforce tax collection from U.S. persons abroad, the practical side effects are considerable, as demonstrated above. It is widely believed that FATCA, with all of the entities and countries attempting to comply, will ultimately result in greater tax revenue generated from offshore taxable assets. Until that day arrives, however, the use of a federal sales tax to raise interim revenue is much easier to implement and enforce through requiring sellers to collect, report, and remit the taxes to the IRS, much like employers withhold and report income tax funds from their employees' paychecks. While the federal sales tax would certainly receive complaints from those affected by it, in both its payment and collection, the system for reporting sales taxes already exists in most if not all states in one form or another, and its enforcement will not be subject to many of the objections now raised against FATCA by not only the world's banking institutions but also the foreign countries where they are located. ■

[37] *Id.*