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Non-compliance with FATCA by China would not prevent Asia-wide implementation, say industry officials

Nov 19 2012 Ajay Shamdasani, Compliance Complete

Should China decide not to sign on to the U.S. Foreign Account Tax Compliance Act, or FATCA, the rest of Asia would likely still comply with it, said industry officials. Earlier this month, several Asian jurisdictions were named by the U.S. Treasury as being in talks over the signing of inter-governmental agreements (IGAs) with the U.S. for complying with the act.

"Clearly China is influential in the region and if China chooses not to cooperate it will not be helpful," Charley Kinsley, a partner with KPMG in Hong Kong, told Compliance Complete. "I am not however convinced it would be a significant blow to regional implementation," he said. Kinsley added that there did seem to be some evaluation of FATCA within China, although, there has been no official word on Beijing's position.

Enacted in 2010, FATCA requires overseas financial institutions that have accounts held by American customers valued at more than $50,000 to report some client information to the Internal Revenue Service (IRS) — the U.S. Treasury Department's collection arm — or face stiff penalties. Beginning in 2014, institutions failing to comply could effectively be locked out of U.S. financial markets. When enacted, FATCA caused uproar among foreign financial institutions (FFIs) about compliance costs and the law's potential for infringing national financial secrecy laws.

Rather than imposing a one size-fits-all approach, the Treasury has pursued a process of government-to-government agreements that, in some cases, let banks report information to domestic tax agencies, which will pass along the information to the IRS. Proposed FATCA rules expected to spell out more details for financial institutions were announced in February 2012, but have not yet been finalised. Businesses worry about having inadequate time to prepare for the law's start date, tax officials have said. The Treasury's goal is to have the FATCA rules published by year's end.

The statement from the U.S. Treasury in early November said that the Cayman Islands, Gibraltar and Liechtenstein — commonly viewed as tax havens — were in FATCA discussions with it. One Asian jurisdiction sometimes viewed as a tax haven is Singapore, however it has also said it is in talks with the U.S. Treasury to reach an inter-governmental agreement on FATCA.

"This is in line with Singapore's role as a responsible tax jurisdiction and our commitment to safeguard our financial system from being used to harbour illegal proceeds," the Ministry of Finance and Monetary Authority of Singapore said in a joint statement. "A private sector advisory panel will be formed to provide industry inputs to the talks," they added.

An agreement between Singapore, a key regional private banking hub, and the U.S. could reduce the regulatory burden on its banks if Washington is satisfied that the city-state has adequate arrangements in place to prevent tax evasion by U.S. citizens.

What if China holds out?

Seeking to rein in offshore tax evasion, the U.S. Treasury earlier this month said it was in ongoing talks with 50 jurisdictions — but it only listed 47 of them, plus the UK: the only country to sign a final FATCA deal. The Treasury added it was close to finalising tax information-sharing pacts with countries ranging from Canada to islands such as Guernsey and the Isle of Man. The 47 jurisdictions ranged India to Saint Maarten; they were in various negotiation stages on formal agreements governing how their local financial businesses could comply with FATCA.

Notably absent from U.S. Treasury's list was China and Hong Kong.

But despite China and Hong Kong not being on the 50-country list, it would be premature to suggest that they had rejected the Treasury's FATCA proposals, said Timothy Clough, a partner with PwC in Hong Kong. "These bilateral discussions are sensitive and require lengthy government-to-government negotiations and we suspect many countries would prefer them to remain undisclosed until a firm position has been agreed between all parties," he said. "Over the forthcoming months we fully expect IGAs to be agreed between the U.S. Treasury and a number of Asian countries."

Likewise, the absence of China from the list could come down to a desire for greater confidentiality or a delay due to the leadership transition in Beijing, said Karl Egbert, a partner with law firm Dechert in Hong Kong. "I am not willing to give up on some sort of a deal being struck," he said. Egbert stressed that the U.S. Treasury's list should not be viewed as definitive. "It could get longer," he said.

Furthermore, not all major financial centres or key U.S. trading partners were listed in the recent announcement. "The fact that a country is not currently considering an IGA does not mean that it may not decide to enter into IGA discussions at a future time," Alan Granwell, a partner with law firm DLA Piper in Washington, D.C., told Compliance Complete.

While the status of China's cooperation or non-cooperation with FATCA remains unclear, some suggested an agreement was likely. "China will probably enter into an IGA with the U.S.," said Jim Calvin, partner at Deloitte in Singapore.

If Beijing does not acquiesce to Washington's wishes, the penalties could be high.

"China is a large player in the current economic order. Its actions regarding FATCA implementation have material implications for itself as well as the U.S. and its FATCA partner nations," said Stanley Foodman, founder of Foodman CPAs & Advisors in Miami. "It [China] risks being seen as a non-transparent nation," he warned.

Foodman said non-compliance by China meant that the flow of funds of funds from the U.S. and other nations into China could be adversely affected, coupled with a 30 percent withholding tax under FATCA for all U.S.-sourced income. "It risks negatively impacting its correspondent banking relationships with the U.S. and other FATCA participating nations … and it risks gaining a reputation as the largest international umbrella for tax evaders."

Yet, Beijing's concerns regarding sovereignty must also be factored in.

"The answer to this question may ultimately rest with the delicate balance China walks between asserting its 'sovereign nation feelings' and its desire to be seen as a law abiding member of the international group of nations by supporting a widespread economic need for eliminating international tax evasion," Foodman said.

Philip Rodd, a partner with Ernst & Young in Hong Kong, added that the Chinese government has commented previously that it is looking to find a cooperative solution with the U.S. with regards to FATCA implementation.

Compliance issues

The uncertainty and the complexity of the multiple bilateral FATCA agreements will increase the burden that FFIs face trying to comply with FATCA. "As time passes by, without clear direction on which countries will opt to be 'FATCA partners' and in what form, the risk of financial institutions failing to comply with the FATCA regulations and yet-to-be-agreed bilateral reporting framework by the required deadlines increases substantially," Clough said.

Having an IGA is seen as beneficial from a country perspective as it helps overcome local legal impediments, and facilitates reporting and withholding. Yet, core issues such as identifying U.S. persons and U.S.-sourced income were still required, said KPMG's Kinsley. "The time it may take for IGAs to be negotiated and local legislation introduced to enforce IGAs may lead to banks and other financial institutions operating in Asia-Pacific having to manage different start dates and having to implement different processes and procedures depending on which model IGA gets implemented and what carve-outs get agreed."

Some Asian countries, however, may choose to not establish IGAs with the U.S. Treasury.

"The lack of a standardised approach and set of agreements across key markets in Asia will increase the operational challenge that Asian institutions face in trying to comply with the requirements of FATCA," said PwC's Clough.

The most concrete takeaway, according to Dechert's Egbert, was that if one is in a jurisdiction with a Model I FATCA agreement, there is no need to enter into an FFI agreement with the IRS. With a Model II agreement, some registration with the IRS was required, he said. "Regardless of whether you're dealing with a Model I or Model II approach, the list of exempted entities in the appendix to your [jurisdiction's] agreement is important. If a [foreign] government can identify problem entities that possess a low risk of U.S. tax evasion, that would be tremendously helpful," Egbert said.

A U.S. congressional panel estimated in 2010 that FATCA would raise $8.7 billion in new tax revenues over 10 years.

(Additional reporting by Patrick Temple-West in Washington, D.C., and Rachel Armstrong in Singapore)

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