

# Opinion

Sarah Mehrtens  
Chief Executive, New Zealand Bankers' Association

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## Washington's tax offensive

In light of the United States debt crisis that played out in Washington DC this year, it's not surprising that the US Internal Revenue Service (IRS) is trying to clamp down on tax abuse. The US government is trying to find every dollar it can. One way the US has hit on is to scour the planet to find US citizens resident in other countries to make them pay their dues. The mechanism for this initiative is the Foreign Account Tax Compliance Act, also known as FATCA, which is due for phased implementation from mid 2013.

FATCA essentially aims to get all financial institutions in the world to identify and report to the IRS on their US customers. Of course the US government cannot require global compliance with its law, but it wields a hefty stick to encourage 'voluntary' agreements between foreign financial institutions and the IRS through severe tax consequences. Financial institutions that do not enter IRS agreements will be penalised with a 30% withholding tax on US-sourced payments and so-called 'passthru' payments made by other financial institutions. These 'passthru' payments could include non-US payments and would be extensive in coverage. Opting out is not a realistic option due to the dominant financial position of the US and the interdependent nature of global finance.

Faced with this extraordinary unilateral demand, what are the implications for the world's financial institutions? In New Zealand we have identified three major issues with FATCA, which resonate with other countries. The first is around compliance costs. The IRS is effectively forcing financial institutions everywhere to be its agents, and requiring them to pay for the privilege. FATCA is projected to raise US\$8 billion world-wide over 10 years for the IRS. This is a mere drop in the ocean compared to spiralling US government debt. The cost of compliance world-wide has been estimated at a staggering \$10 to \$20 for every single dollar the IRS retrieves. On any cost-benefit analysis this just doesn't stack up. The benefits to the IRS are trifling compared to the costs imposed globally. This boils down to an estimated cost to the New Zealand financial sector running into the tens of millions, although it's difficult to quantify the actual cost while the regime's details are still being worked out.

The second big problem is how FATCA impacts on countries' privacy laws. Under the Privacy Act 1993, financial institutions in New Zealand can pass on private customer information if doing so is required by New Zealand law. However, FATCA is technically 'voluntary' for non-US institutions and is not required under New Zealand law. Therefore, in order to collect the information and release it to the IRS, financial institutions will have to obtain a signed consent from every customer. Where no consent is obtained, for whatever reason, institutions will either have to withhold a percentage of all funds transferred to that customer, or close the account.

The third major problem is the risk to financial stability due to the currently unworkable withholding provisions. Under FATCA, compliant financial institutions have to withhold money from payments to non-compliant institutions and customers. Settlement systems generally have no provision for withholding tax to be applied to settlement proceeds. This means payments made by compliant institutions will come up short where a portion has been withheld. The ripple effect of this on settlement systems would be highly destabilising.

So how do you solve a problem like FATCA? As previously noted, opting out is not an option. New Zealand already has a tax treaty with the United States. It makes sense to use the existing reporting arrangements under that agreement to meet the need to report on US customers, rather than having to build a whole new expensive system as envisaged by the US legislation.

Governments will also need to look at their privacy laws to see if they should or could be amended to remove the need for extensive customer consents.

On the workability of the withholding provisions, the New Zealand Bankers' Association is working with counterparts in Australia, Canada and the United Kingdom. The answer here is not entirely evident.

Other issues will undoubtedly arise out of this global conundrum, along with possible solutions. Already the threat of other countries imposing FATCA type regimes has raised its head. The world is running out of time to get its ducks in line. Watch this space.