Enforcing the Foreign Account Tax Compliance Act in the Philippines

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The Foreign Account Tax Compliance Act (Fatca) is a US legislation that is part of the 2010 Hiring Incentives to Restore Employment (HIRE) Act, and forming part of four new sections incorporated into the US Internal Revenue Code. It is a law designed to improve offshore US tax collection by eliminating tax avoidance and evasion.

According to the Internal Revenue Service (IRS), Fatca is “an important development in US efforts to combat tax evasion by US persons holding investments in offshore accounts.” Specifically, it requires US citizens to report their offshore financial accounts and to require foreign financial institutions (FFIs) and nonfinancial foreign entities (NFFEs), in this instance, banks and insurance companies in the Philippines, to report to the IRS accounts of their American clients. This reporting obligation requires reports on US account holders’ names, TINs, addresses, as well as accounts balances and withdrawals. The premise of the law is that much tax revenue can be collected overseas particularly in tax havens. This is a major shift in US tax policy. The US imposes taxes on the worldwide income of its citizens and resident aliens.

FFI includes any non-US entity that: a) is engaged in banking or similar business; b) holds financial assets for the account of others as a substantial portion of its business; c) is in the business of investing, reinvesting or trading in securities, partnership interests, or commodities; or d) is engaged in certain insurance related activities.

The target of Fatca are “US persons,” meaning US citizens and US permanent residents who are residing outside the US. Reporting of these US persons are made through Form 8938, which is filed together with the US tax returns if they are worth more than $50,000. As a penalty, these US persons will be subject to a 40-percent penalty for underreporting of income. On the other hand, FFIs are required to report to the US Treasury foreign financial accounts exceeding $10,000. Non-compliant FFIs will be subject to a 30- percent withholding tax on certain payments to the FFI from US sources, such as interests, dividends, rents, royalties and other types of “fixed and determinable” income, on top of the other usual taxes.

The Fatca has been the subject of numerous criticisms. One of these is that FFIs and foreign regulators have been converted into “unpaid IRS agents” and the cost of implementing it far outweighs the projected gains.

The reporting obligation has posed legal obstacles, the most contentious of which is the legality of FFIs disclosing the required information in possible violation of domestic laws, such as those on data protection rules and confidentiality issues. Specifically, the Bank Secrecy law (RA 1405) and the Data Privacy Act of 2012 (RA 10173).

The remedy to this legal obstacle is the conclusion of an intergovernmental agreement (IGA) with the US government. In this regard, the US Department of Treasury has drafted model IGAs. One model proposes that FFIs will report the required information to the local tax authority (i.e., the Bureau of Internal Revenue), and it is the Bureau of Internal Revenue that will provide information to the US authorities. A variation model is where the US will be bound to share information to another jurisdiction on a reciprocal basis. The first Fatca IGA was signed by the US with the United Kingdom on September 12, 2012. Once the IGA is in place, the FFIs will be called “participating FFIs.” This IGA is subject to ratification by the Senate.

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