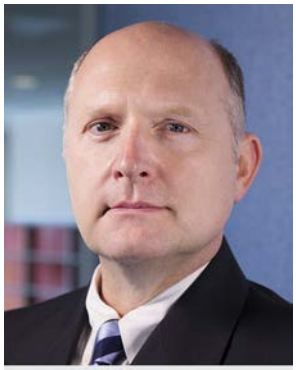
In Praise of Postponement: What Dutch Banks Tell Us About FATCA

by Robert Goulder



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Some people in the Netherlands had September 1 circled on their calendars. It was the latest in a string of deadlines, agreed to by U.S. officials, for enforcement of penalties under the Foreign Account Tax Compliance Act.

The FATCA regime has been operational for years, but a key element of its application to some foreign financial institutions has been selectively postponed on several occasions. This relates to the imposition of heavy penalties on FFIs with recalcitrant account holders.

Short of a last-minute reprieve, September 1 was to be the date when Dutch FFIs would face the consequences of having noncompliant U.S. account holders as clients. That refers to any account holder designated as a U.S. person for FATCA purposes who has failed — despite repeated demands — to provide their taxpayer identification number or a certificate of loss of nationality. Without the critical documentation, the FFIs would choose to terminate the accounts rather than incur the penalties.

The problem is not limited to Dutch banks. FFIs around the world continue to struggle with noncompliant account holders. Lots of them, in fact. I doubt many people would have foreseen this situation when FATCA was enacted in March 2010, fresh on the heels of the UBS banking scandal. Twelve years is a long time. You'd think the inventory of problematic accounts would have been weeded out by now. That it hasn't reveals a blind spot in the regime's grand design.

It's tempting to conclude that the singular problem here is the lingering presence of all these accounts for which foreign banks lack TINs or loss of nationality certificates. Allow me to suggest that's a merely a symptom. The root defect of FATCA is that Congress constructed an extraterritorial reporting regime that ignored the reality that citizenship-based taxation is a rude deviation from the established international norm.

Think of it like this. We are not bothered when foreign banks terminate the accounts of offshore tax evaders. Those people are cheaters; they merit no sympathy. Throw the book at them. However, none of the concerned parties — including the U.S. Treasury Department and the IRS — are eager to see foreign banks close the accounts of accidental Americans.

We observe vastly differing tolerances for account termination depending on whether the affected individual is a scoundrel or a victim of circumstance. FATCA fails to distinguish between these two categories. It clumsily lumps them together as "U.S. persons" despite our reasonable expectations that they should face very different outcomes.

Why do I roll my eyes when advocates speak glowingly of FATCA's reformative attributes? That's because it fails to distinguish between villains and innocents. As enacted, it doesn't even attempt to do so. That's one heck of a design flaw when you ponder the regime's far-reaching scope. Sure, Treasury would like to patch the shortcomings, but that's challenging when the crux of it is something only Congress can remedy.

No other nation encounters the same difficulty. You don't hear about accidental Swedes or accidental Koreans causing headaches for those countries' tax authorities. Why is that? It's because the rest of planet Earth adheres to residence-based taxation and relies on the OECD-brokered common reporting system for their information exchange needs.

Anytime someone tells you that the plight of accidental Americans doesn't matter because they're relatively few, it's a signal the speaker hasn't got a solution for dealing with them. It's an admission of failure.

Given that adoption of residence-based taxation is beyond their regulatory authority, I give U.S. Treasury officials credit for doing the next best thing — delaying the imposition of severe penalties on FFIs when the foreign government in question is playing nice. We're talking about Dutch banks because the Netherlands plays nice with Washington when it comes to FATCA, even if it doesn't necessarily like the regime.

Over the years, we have seen various FATCA deadlines be postponed, and then postponed again. Readers may recall the FATCA grace period, which lasted roughly from 2017 through the end of 2019. It was intended to provide foreign banking systems sufficient time to conform to FATCA's unique demands before the penalties kicked in. The grace period was an excellent idea, but its winding down did not cause these issues to go away. FFIs still weren't receiving all the TINs. In hindsight, the grace period may have ended prematurely.

Foreign governments, including the Dutch, sought a series of temporary assurances that their FFIs wouldn't be compelled to terminate the accounts of accidental Americans. Each time one assurance expired, a new one would replace it. These informal assurances soon built upon each other, like sedimentary layers. The status quo doesn't seem so different from the grace period, although the permissiveness displayed by U.S. officials can be selectively exercised to reflect the varying degrees of cooperation seen from the opposing government.

Last year, then-Dutch Finance Minister Wopke Hoekstra worked closely with the Dutch Banking Association to obtain yet another informal postponement from U.S. officials. The effort was based, in part, on an understanding that Treasury might release new guidance on FATCA compliance in the spring of 2022. That explains how we arrived at the September 1 deadline — which is now behind us.

It tells us something about the nature of FATCA that the key stakeholders — the governments and the banks — seem content with the non-application of penalties. Nobody is fiercely objecting to the next postponement. We're learning that full application of FATCA penalties to a particular jurisdiction is akin to a switch that can be temporarily turned off at Treasury's discretion. Why switch it back on when there's an acknowledgment of pending harm to the accidentals?

Adherence to the rule of law dictates that statutes must be enforced . . . eventually. This column praises selective forbearance as a path to enlightenment.

Batchelder's Letter

The September 1 deadline came and went without chaos reigning over the Dutch banking system. That was courtesy of an August 29 letter from Lily Batchelder, Treasury's assistant secretary for tax policy. The letter was addressed to André Haspels, the Dutch ambassador to the United States, with a copy sent to Dutch Finance Secretary Marnix van Rij.

The letter's language reflects balance between accommodating the practical needs of accidental Americans and giving absolutely nothing away:

> We value our collaboration with the Netherlands in countering offshore tax evasion and improving international tax compliance. We believe that it is in our mutual interest for U.S. citizens resident in the Netherlands to continue to be able to access basic bank accounts in the Netherlands in order to conduct their ordinary course daily financial activities like the receipt of wages and the payments of bills.

So far, so good. Reading between the lines, that sounds like something you'd expect to hear from a proponent of the same-country exception. Note the reference to shared interests. Then there's a blunt reminder of what U.S. law formally demands:

> However, we wish to again emphasize that obtaining U.S. TINs from U.S. citizens holding accounts at foreign financial institutions (FFIs), including accounts located in their country of residence, is crucial to ensuring that the U.S. Internal Revenue Service (IRS) has the tools it needs to determine whether U.S. citizens are complying with their U.S. tax obligations.

The act of sending conciliatory letters to foreign ambassadors is not the preferred method for setting new government policy. To be clear, there is no substantive change in the bottom line. The IRS still needs the TINs — eventually. There's no getting around that.

What's the purpose of the letter? Comfort arrives in the next paragraph, which provides a justification for continued forbearance. It's a teaser of FATCA guidance that may lie ahead:

> In order to address the concerns described above in a balanced manner, the Treasury Department and the IRS intend to develop and publish guidance that we expect will provide that FFIs that follow specified procedures will not be treated as significantly noncompliant with their reporting obligations under the IGA solely because of the failure to report U.S. TINs for certain types of accounts.

That doesn't let anyone off the hook for the relevant intergovernmental agreement requirements. It does, however, preview that forthcoming guidance will illuminate what it means for a foreign bank to be in significant noncompliance with FATCA. The practical effect of the guidance — if it's published — will be leniency toward all affected FFIs (not just the Dutch) under specific circumstances. Again, nobody is complaining about these penalties not being enforced.

Interestingly, the relief might be conditioned on IGA partners' taking cooperative steps on external communications directed at U.S. account holders. That sounds like a quid pro quo:

> The guidance is expected to require that our FATCA partner jurisdictions take certain steps to increase the likelihood that U.S. citizens residing within their border will report U.S. TINs to the relevant FFIs as a condition to relief for FFIs in the jurisdiction. This guidance is intended as a first step towards potential permanent relief for foreign financial accounts of U.S. citizens resident abroad that pose a low risk from a U.S. tax compliance perspective.

My initial reaction is that the term "FATCA partner jurisdiction" should be retired. It's condescending. Objectively, there is no country in the world that wants to partner with the United States on FATCA. The statute was an exercise in unilateralism. It was bullying.

Better to call these other jurisdictions what they are — IGA signatories — and leave it at that. If Congress gave a fig about having equal partners for information exchange, it would embrace reciprocity and convert to the common reporting standard.

My second reaction is that the envisioned quid pro quo may prove cumbersome. Which concrete actions will suffice as best efforts, and who is to judge their adequacy? Must other jurisdictions post advertisements in newspapers and periodicals? Must they place public service announcements on radio, television, and social media outlets?

Some countries have already taken similar measures. A few years ago, the Dutch Banking Association produced an animated video explaining FATCA compliance for the benefit of affected parties. The cartoon was posted on its website as the previous grace period was nearing expiration. Perhaps it'll need to circulate a refresher as a condition of obtaining regulatory relief.

If we're honest, there's something awkward about the U.S. government nudging foreign governments to produce infomercials on what is required for *their* residents to comply with *our* laws. It's the equivalent of asking your neighbors to mow your lawn; it's a task you should be doing yourself.

Wouldn't it be strange for U.S. banks to run public service announcements about what was required of U.S. residents under the French legal system? Such is the nature of an extraterritorial reporting regime.

Batchelder's letter concludes with a confirmation that the Dutch wanted to hear:

> We hope that based on this information Dutch FFIs will not close accounts of U.S. citizens resident in the Netherlands who do not provide U.S. TINs prior to the issuance of the published guidance. We appreciate the constructive dialogue that we have had on these issues and look

forward to future collaboration and cooperation.

Play nice and good things will happen. It's almost like the grace period never ended; and that's just fine.

Waiting for Godot

The ongoing postponements make sense if the long-term plan is for Congress or Treasury to fix FATCA. Off the top of my head, I can think of three reforms that will do the trick:

- add a same-country exception, which is just common sense at this point;
- replace citizenship-based taxation with residence-based taxation, which is an established international norm; or
- better yet, eliminate FATCA altogether and join the OECD-brokered common reporting system that's relied on everywhere outside the United States.

This is aspirational stuff, but it would produce a blanket approach to automatic exchange of information. The scheme would be globally standardized and globally reciprocal — and probably more durable than our current arrangement. ■