Lessons From Account-Level FATCA Filings

by Robert Goulder

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Over the years, these pages have presented ample criticism of the Foreign Account Tax Compliance Act. This week's column looks at FATCA from a different perspective, drawing influence from a new research paper that examines aggregated data from several years of FATCA filings. The paper was published last month by the National Bureau of Economic Research and lists multiple authors, including prominent academics and two IRS employees.[1] It's a different twist on a familiar topic.

Before we get to the details of the NBER paper, let's review my basic criticisms of FATCA. This isn't piling on. Knowing the issues helps contextualize the new research findings.

Criticism #1: Data Protection

First, there's the matter of how FATCA aligns with the expanding field of data protection. A fair argument can be made that FATCA (a U.S. creation with global reach) is on a collision course with the General Data Protection Regulation (GDPR — an EU creation with global reach). The status quo resembles a standoff in which the stakeholders are willing to ignore possible transgressions for the sake of not disrupting transatlantic relations.

Every so often this truce is threatened by private litigants who want to use European courts to obtain the kind of judicial determination that EU diplomats would not dare to speak. The litigation activity spearheaded by U.K. solicitor Filippo Noseda is at the front and center of that effort.[2] It will be a fascinating moment if the Court of Justice of the European Union were to declare that all the intergovernmental agreements signed by EU member states contravened primary EU law. But let's not get ahead of ourselves. The commission strains itself to avoid that outcome, as if its priority were to protect the IGA network. That's odd since FATCA is not its baby. You'll be forgiven for thinking the commission's allegiance ought to be to preserve the integrity of GDPR, which very much is its baby.

The dissonance is explained as a case of governments developing a vast data protection regime with the assumption that the resulting rules would strictly apply to private actors (think Google and Facebook) while applying less strictly — if at all — to their own taxing functions and all things appurtenant to that activity. If there's some reason why generally applicable data protections must not extend to the domain of tax administration (including information exchange among national revenue bodies), then somebody should say so. In the meantime, Noseda's clients are left wondering why the commission cares more about Washington's IGA network than the statutory rights of EU citizens.

[1] Joel Slemrod et al., "The Offshore World According to FATCA: New Evidence on the Foreign Wealth of U.S. Households," National Bureau of Economic Research, Working Paper 31055, Mar. 9, 2023. Although two of the authors (John Guyton and Patrick Langetieg) are employed by the IRS, the foreword explains that all findings, opinions, and errors are those of the authors and do not necessarily represent the opinions of the IRS or the Treasury Department.

[2] The basic problem is that the IGAs entered into between the U.S. government and EU member states (acting individually) were not drafted with the GDPR or other data protection concerns in mind. That's not surprising since the IGAs are heavily one-sided instruments. The "negotiation" of these instruments (such as it was) would have been more balanced had the EU states banded together as one, resulting in a singular IGA applied to the whole of the EU bloc. That never happened, and it shows in the terms of the neglectful posture toward data protection. We now know that the European Commission was well aware of these concerns during the formative time period, 2010-2012, following FATCA's enactment. For related commentary, see Filippo Noseda, "EU Playing Politics With Fundamental Rights Over FATCA and Public Registers," *Tax Notes Int'l*, Oct. 10, 2022, p. 189. For prior coverage of recent developments, see also Elodie Lamer, "EU Considers GDPR's Implications for Tax Information Exchange," *Tax Notes Int'l*, Jan. 16, 2023, p. 397.

Criticism #2: Citizenship-Based Taxation

My second criticism of FATCA relates to the regime's interplay with citizenship-based taxation. A lot of FATCA critics would be OK with the concept of third-party reporting by foreign financial institutions, assuming we could redefine what constitutes a U.S. person. Replace citizenship-based taxation with residence-based taxation — the global norm — and suddenly FATCA looks more tolerable. After all, third-party reporting is a proven tool for snaring all manner of tax cheats.[3] Think about what third-party reporting does for voluntary compliance rates domestically.

Amending FATCA to include a same-country exception is not the same thing as converting to residence-based taxation. Still, it's a step in the right direction.[4] Let's recall the selling point for a same-country exception. The U.S. tax code should be worried about the plastic surgeon from Beverly Hills who keeps his wealth concealed in bank accounts in the Cayman Islands, where he's not a resident. That's the crowd FATCA should target. Contrast that situation to an individual who expatriated long ago and spent years establishing residence in an adopted host country, and who naturally must engage in routine banking activity. The common element between these two scenarios is the existence of non-U.S. bank accounts; the distinguishing feature is the concept of residence.

I maintain that FATCA need not bother with the latter person. This assumes we can agree that our residency rules work as intended and are not being systematically gamed. If that's a flawed assumption, then I'd have no objection to strengthening the residence rules as needed, though I don't believe that's necessary.[5]

Criticism #3: CRS is Preferable

Information exchange based on treaty requests is a cumbersome thing. A generation ago it was all we knew. Today it feels wholly inadequate. The automatic exchange of information has been a game changer, and it's remarkable how quickly that transition took place. FATCA is responsible for this progress, but looking at it you'd think the process is destined to be a one-sided affair that benefits the party with more leverage. FATCA has always resembled a feudal estate because it's composed of identifiable servants and a single master. Automatic information exchange doesn't need to be that way.

Once FATCA was enacted, it didn't take long for other governments to decide they wanted in, but through a mechanism based on mutuality. The OECD-backed common reporting system (CRS) features the reciprocity that FATCA lacks. Objectively, it's the better approach. It's rude for the U.S. government to demand account data from FFIs — justified by the legitimate needs of tax enforcement — and then explain to the rest of the world that U.S. banks won't be returning the favor. We can't have those affluent depositors from Latin America withdraw all the money they've stashed in Florida or Texas.

What about "America First"? As I see it, information exchange that isn't reciprocal is less likely to endure, so it's in the long-term interest of the United States to support a system based on reciprocity. Then there's the efficiency of a single platform. As things stand, banks must undertake FATCA and CRS compliance, resulting in duplicative costs. What if another large economy — say China — were to implement its own version of FATCA? Would India and Brazil soon demand their own unilateral mechanisms? Uniting behind CRS fends off unwelcomed

[3] Had the qualified intermediary regime and know-your-customer procedures been more diligently adhered to by foreign banks, we probably would not have ended up with FATCA. Among other things, the UBS scandal (2008-2009) stands for the proposition that FFIs were ignoring QI agreements from the moment they signed them. For the most part, that disregard was occurring without repercussions. The UBS episode also confirmed what everyone had always suspected — that these foreign banks' internal know-your-customer practices were a farce. I emphasize these points because the thing the QI regime and know-your-customer practices have in common is that neither was legitimate third-party reporting. They were enforcement per the honor system, where honor was in short supply.

[4] For prior analysis, see Robert Goulder, "Expat Relief: Is the Beyer Bill as Good as It Gets?," *Tax Notes Int'l*, Jan. 10, 2022, p. 251. For a discussion of whether conversion to residence-based taxation could be revenue neutral, see Goulder, "Would Residence-Based Taxation Break the Bank?," *Tax Notes Int'l*, May 16, 2022, p. 973. For a more cautionary approach to residence-based taxation, see Patrick Driessen "Beware High-Wealth Tilt in Residence-Based Tax Plans," *Tax Notes Federal*, June 17, 2019, p. 1839.

[5] Some of the pushback I encounter to residence-based taxation boils down to people not trusting the residence rules. If those rules are enablers of offshore tax evasion, then by all means, let's fix them. Conceptually speaking, not trusting your residency rules strikes me as a lazy reason for adhering to citizenship-based taxation.

overlap. Let there be automatic information exchange, but let it be as rational and efficient as possible.

For now, none of that matters. Washington has zero interest in swapping FATCA for CRS. That's unlikely to change until Treasury views CRS as an upgrade — and it's difficult to see how that would come to pass. Once a nation has gone to the trouble of constructing an elaborate data harvesting machine, there's little incentive to unwind it for the sake of multilateral harmony. Exceptionalism goes along with first-actor status. Purists may prefer CRS, but FATCA got there first.

Slemrod and Company

The above criticisms are instinctive policy arguments. They say nothing of the knowledge to be gleaned from a careful evaluation of account-level information. FATCA has been operational since 2015, so we have several years of FFI filings (Form 8966) to bolster our insights about who feels the regime's brunt. FATCA filings cover 45,000 FFIs located across 190 jurisdictions, and about 4.5 million U.S.-owned accounts. Not all those accounts can be matched to a known U.S. taxpayer because of the prevalence of missing taxpayer identification numbers. Missing TINs are a drag, but they don't prevent researchers from drawing conclusions about FATCA.

The NBER research paper acknowledges the basic challenge of taxing capital income from foreign sources. The authors put it as follows:

> Many taxpayers have long been able to evade capital income taxes, wealth taxes, and inheritance taxes by holding wealth through banks in countries with a strong commitment not to share information, in the form of bank secrecy and other measures. Basic facts about the magnitude and composition of offshore financial wealth remain elusive, because of its characteristic opacity, which in turn creates difficulties for efforts to estimate the distribution of wealth across countries.

The NBER paper sheds light on all of that. It's unique in that it measures the aggregate foreign wealth of U.S. households, with a distributional analysis by income grouping. Other researchers have attempted the same exercise relying on macro-statistics. Here, the authors use administrative data, which seem far more accurate. They observe a "steep income gradient in the propensity to hold assets in foreign financial institutions."[6]

They weren't kidding about the steepness. Among taxpayers in the top 0.01 percent of the income distribution (that is, the top one-hundredth of the 99th percentile), 60 percent owned foreign assets, usually in tax havens. Participation declines sharply as we slide down the income scale. Among individuals in the bottom half of the top 0.1 percent of the income distribution (still occupying the top one-tenth of the 99th percentile), 40 percent held foreign assets. Among those in the bottom half of the top 10 percent of the income distribution (between the 90th and 95th percentiles), less than 5 percent held foreign assets.

At the risk of oversimplifying things, the NBER research paper confirms that the wealthier you are, the more likely it is that you hold wealth offshore. Moreover, offshore participation isn't just concentrated among the affluent — it's *super*-concentrated among the *super*-affluent. That makes FATCA predominantly (but not exclusively) the business of one-percenters.

Some other things jump out from the data. The very largest foreign accounts are disproportionately held by partnerships. For the 2018 tax year, the authors sorted filing data by the type of account holder. While partnerships made up just 1.4 percent of the reported accounts, they accounted for a whopping 32 percent of reported account balances. Other entities (C corps, S corps, tax-exempts, trusts, etc.) made up 1 percent of the accounts and 14 percent of the reported wealth. Individuals made up 55 percent of the accounts and 15 percent of the wealth. Another 25 percent of reported wealth related to accounts for which no owner type could be matched. That's mostly explained by missing TINs. A decade into FATCA, and absent TINs continue to be a fact of life.[7]

The role of partnerships comes up again when the authors sort data by location, distinguishing between tax havens and non-tax-havens. More

[6] Slemrod et al., *supra* note 1.

[7] If you could sit down and chat with the architects of FATCA, I suspect they would be surprised that roughly a quarter of the foreign wealth reported by FFIs can't be matched to a U.S. taxpayer.

than half the reported foreign wealth in tax havens was held by partnerships. That is, 52 percent of reported wealth from matched accounts, plus the corresponding percentage for unmatched accounts — which cannot be determined but is clearly not zero. Contrast that with the data for non-tax-havens, in which only 14 percent of wealth was held by partnerships. For whatever reason, a jurisdiction's status as a tax haven functions as a magnet for the use of partnerships to hold wealth.

I've often wondered if the occurrence of unmatched owners (reported accounts with missing TINs) is more prevalent among tax havens. The NBER research paper tells us the opposite is true. Unmatched accounts represent 62 percent of reported wealth in non-tax havens, but only 12 percent of the reported wealth in tax havens. There's no obvious answer for this finding.

The authors suggest it could be attributable to the expectation of scrutiny that comes with tax haven status. In other words, FFIs based in a place like the Cayman Islands might have been particularly tenacious at coaxing TINs out of their account holders, whereas FFIs in a high-tax country like France might have been more casual about the same task — or felt less pressured to chase TINs. Another possibility is that missing TINs are closely associated with accidental Americans (think Boris Johnson before renunciation of his U.S. citizenship), and there's no reason those individuals would be concentrated among tax havens as opposed to normal population centers.

None of these findings are direct proof that ultrarich U.S. taxpayers are using partnerships in tax havens to evade federal income taxes. However, the paper does inform our thinking about where offshore wealth lives (hint: in tax havens) and what kind of entities are used as account holders (hint: partnerships). This should inform IRS risk assessment going forward, though I suspect it already knew these things.

Progressivity, Please

The inescapable takeaway from the NBER paper is that the bulk of FATCA reporting is about the ultrarich. That stems from the authors' examination of foreign account ownership across all income profiles, relying on adjusted gross income as an accepted measure of income and the matching of TINs to Form 1040 filers.

What should we make of the authors' conclusion? It's no revelation that poor folks hold less wealth offshore than rich folks — they have less wealth, period. Nor it is surprising that the moderately affluent hold less wealth offshore than the highly affluent, for the same reason. A tempting conclusion is that, to the extent FATCA has an observable revenue effect (from promoting greater voluntary compliance), its incidence should be highly progressive. That finding shouldn't be controversial. Everyone understands that FATCA is not a taxing provision, per se. But it's still geared toward enhanced compliance — and that's occurring mostly at the high end of the income distribution. It would follow, then, that any effort to scale back FATCA or narrow its extraterritorial reach would cut against progressivity.

You can see where this is going. If more FATCA delivers greater progressivity, then less FATCA must translate to a more regressive tax system. It follows that every time I call for a same-country exception, I'm indirectly begging for less progressive outcomes — not by intention, but that's the anticipated effect.

Economist Patrick Driessen made a similar point several years ago, in the context of discussing the pros and cons of conversion to residence-based taxation:

> RBT [residence-based taxation] would exempt from U.S. taxation the foreign income of citizens abroad. Short of a full-fledged examination of the normative, empirical, and comparative issues concerning cost, benefit, and granting of citizenship, this article offers observations that may give pause about adopting RBT. . . . The essentially unrestrained tax exemption embodied in various RBT proposals offered just for Americans abroad could disproportionately benefit a select group of high-capital-income and high-wealth citizens residing in the United States and abroad, which raises equity and revenue concerns.[8]

[8] Driessen, *supra* note 4.

Driessen is not wrong about those equity and revenue concerns. The high-wealth tilt he describes is there to be reckoned with. The NBER paper bolsters the idea that the concerns apply just as strongly to FATCA. Perhaps more so, given the super-concentration observed in the filing data.

Note the predicament in which we FATCA critics now find ourselves. Should we continue to raise serious policy objections to FATCA, when a possible consequence of reform would be that the wealthiest U.S. taxpayers are less affected by third-party reporting? What if an otherwise sound tax policy adds nothing to progressivity because some (or most) of the expected benefit falls to the wealthy?

Is progressivity the sole litmus test by which all fiscal reforms must be judged? Is it exculpatory to point out that our tax system tolerates many other provisions that do absolutely nothing for progressivity? Itemized deductions come to mind. People talk about the need to repeal the state and local tax cap introduced under Tax Cuts and Jobs Act, but is that any less offensive (in terms of progressivity) than talking about FATCA reforms? I don't know the answers to these questions, but I raise them to highlight the tendency to be selective in where we choose to tolerate non-progressive fiscal measures. We tolerate state-operated lotteries (basically a tax on people who are extremely bad at math) and I'm hard pressed to think of anything more regressive than that.

There should be some cognitive space between pointing out that FATCA has problems and being a shill for the ultrarich. ■