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A Long-Distance Relationship With the I.R.S.

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The U.S. Internal Revenue Service has never shied away from long-distance relationships. Americans living abroad may still face tax liability back home, and even if they owe nothing, the I.R.S. requires an annual tax return.

Much to the concern of American expatriates, their lawyers and accountants and overseas banks, a law called the Foreign Account Tax Compliance Act, or Fatca, makes even further demands. Fatca calls for foreign financial institutions to file an annual report to the I.R.S., either directly or through its own national tax authority, on each U.S. taxpayer for whom it holds more than $50,000 in assets at the end of the year.

The law also requires account holders to file an I.R.S. form themselves, 8938, detailing their foreign holdings, though American expatriates need file only if their financial assets exceed $200,000 at year's end. To make sure account holders stay in touch, the agency levies a $10,000 penalty for failure to file a required 8938, and any underreported income will be subject to an additional 40 percent penalty.

Even with the penalties, Fatca is not expected to raise significant revenue for the U.S. Treasury; the Congressional Budget Office forecasts a take of $8.7 billion over 10 years. That is barely a rounding error in an annual budget of more than $3 trillion, and accountants and lawyers treat the estimate with extreme skepticism, anyway.

What Fatca is expected to raise instead of money, tax specialists warn, are confusion and expense. After widespread criticism of the law's complexities from banks and expatriate groups — American Citizens Abroad warns on its Web site that Fatca will have a "devastating impact" — the I.R.S. announced in October that it would postpone enforcement by one year, to January 2014. The delay will give those affected by the law time to prepare, time they are expected to need.

"Every foreign financial institution — insurance companies, fund companies, family offices; it isn't just banks — has to enter into an agreement with the I.R.S. to do an ele[ctronic database] search to identify Americans," said Ian Shane, a tax lawyer at the New York [...] Eiseman Assor Bell & Peskoe. "From the moment it first came out, tax lawy[...] mind-boggling."

That was in 2010, in the aftermath of the global financial crisis and the reces[...]

accompanied it. Banks were regarded as major culprits in the turmoil and therefore were vulnerable politically, not just financially. It was seen as expedient to enlist them in an effort to heighten tax compliance.

A significant focus of that effort is Americans who keep money overseas, a group that Mr. Shane contends has unfairly been placed near the top of Washington's list of usual suspects.

"The belief is that if you have a foreign bank account, you must be fiddling your taxes," he observed. "That's patently untrue. The vast majority of people with a foreign bank account have it for legitimate reasons. Businessmen have clients in Europe, so they need a euro account, for example. America is a trading nation and a nation of immigrants."

It is also a nation of lawyers, many of whom are employed by the government. No surprise, then, that the Fatca legislation runs to several hundred pages. Here is the abridged version:

Foreign financial institutions will be required to scour their records for signs that customers are American, like a U.S. address or phone number or instructions to transfer funds to a U.S. bank account. For accounts worth more than $1 million, more rigorous search criteria will be required. Anyone flagged in the search will be asked to provide proof of citizenship and/or residence status, and Americans will have to provide a Social Security number.

The Social Security number of each American account holder, along with the account number, year-end balance and details on income paid into the account as interest or dividends and proceeds from security sales, must be turned over to the I.R.S. according to a timetable that places account holders with big balances at the front of the line: by the end of 2014 for those with $1 million bank balances and by the end of 2015 for accounts of $50,000 to $1 million.

There are deadlines and balance thresholds for other types of accounts, like with brokers, money managers and insurance companies, and for accounts held by entities like corporations and partnerships.

If you are wondering why a financial institution would agree to compile this information for an agency in another country, this is where another penalty comes in. Any payment from an American source to a foreign institution that is not complying with Fatca will be subject to 30 percent withholding, so any bank or other firm that has American customers or does American business may be affected.

Fatca does feature some benign elements, especially for financial small fry: Institutions will not have to report accounts worth less than $50,000, and individuals with less than that sum overseas will not have to file the 8938 form. But anyone with $10,000 abroad still must file a Report of Foreign Bank and Financial Accounts, known as an Fbar, each June 30.

Barbara Angus, a principal in Ernst & Young's U.S. tax department who focuses on international tax, highlights another exception to Fatca that should give a break to many American expatriates: Payments related to retirement plans, either for workers accumulating assets or retirees receiving distributions, are exempt from the reporting requirements. Then there is the one-year enforcement delay, which will forestall headaches for taxpayers. For financial-service companies, however, it is a sign of the enormous task that they are being asked to undertake.

"There are a lot of questions on how each provision needs to be done," Ms. Angus said. "It's very important to have certainty before building changes into information-technology systems. A lot of input is needed from institutions to make those work as seamlessly as possible."

The input is of money, as well as time. According to one widely quoted estimate, by J.P. Morgan Asset Management, multinational banks will have to shell out $100 million apiece on one-time expenditures merely to prepare systems for complying with Fatca.

There will be ongoing costs, too, of course. Financial institutions may decide to write them off as the price of doing business. It is also possible that they will pass them on to their customers or stop serving Americans altogether, reducing consumer choice.

"Large banks will still take U.S. customers, but some smaller banks could end up saying it's too much trouble," said Joseph M. Calianno, leader of the International Technical Tax Practice at Grant Thornton, an American accounting and financial advice firm.

Another potential unintended consequence is damage to U.S. financial markets. A study by BlackRock, an American portfolio-management firm, warned that the withholding requirement could discourage foreign investment in the United States, lest investors suffer a 30 percent haircut when they cash in.

Americans could face adverse consequences from innocent financial dealings, Mr. Shane warned. Businesses of all sorts, not just financial institutions, may shun U.S. companies for fear of running afoul of Fatca, he said. For individuals, certain arcane transactions — say, transferring a large sum into an escrow account as a down payment on an overseas vacation home — could cause someone to fall under the Fatca reporting rubric without his or her knowledge.

Perhaps the biggest threat from Fatca will be faced by individuals who ignored reporting requirements — not of Fatca itself but of its older cousin Fbar, a form that expatriates often ignore, tax specialists say, because it is somewhat obscure and filed separately from tax returns.

When institutions start reporting for Fatca, the I.R.S. is bound to notice account holders who have fallen behind, accidentally or otherwise, in filing their Fbars. Mr. Calianno advises anyone likely to be in that position to consider the Offshore Voluntary Disclosure Initiative, a program that allows late, even negligent, filers to get straight with the I.R.S.

“It’s designed to get people who have foreign bank accounts and didn’t report them in the past to come in and get compliant,” he explained. In general, someone who has paid all tax related to income from foreign accounts need only file overdue Fbars to avoid penalties, he said, while those who owe money along with the paperwork will be subject to minimal penalties.

Mr. Shane likewise encourages expatriates and other Americans with overseas accounts to take the initiative in reconciling discrepancies or oversights that may show up once Fatca is up and running.

“See an accountant or lawyer to see what your options are,” he said. “You always want to be in a position where you’re going to the I.R.S. If the I.R.S comes knocking on your door first, they’re going to take a harder line.”

Americans’ long-distance relationship with the agency never ends, and if they think the adage “out of sight, out of mind” applies, they may want to reconsider.

“A lot of information filed with the I.R.S. doesn’t get looked at,” Mr. Shane said. “This will get looked at.”