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The Treasury
Langton Crescent
PARKES ACT 2600

Subject: Response to consultation on intergovernmental agreement to implement FATCA

1. Introduction and summary

Thank you for allowing public submissions on the important issue of how Australia deals with FATCA. The implications of this regulation are far reaching and little understood, and I am grateful for the chance to add my experiences and point of view into the discussion. My interest is driven by closely intertwined banking systems of NZ and Australia and the recognition that policy decisions for one affect the other.

I am a New Zealand citizen and resident, not Australian. However, what I have to contribute to this discussion is as important and valid as anything that might be submitted by others who are Australian. Specifically, I have highly relevant experiences that underpin the positions I have expressed here.

I have in my recent past been a greencard-holding immigrant to the United States, and have experienced first hand how harshly the US government treats people that have financial ties to other countries. I faced confiscatory penalties for continuing to hold my home bank accounts while living in the US and inadvertently failing to file related forms that are little known to the people who need to file them. I was subjected to highly coercive threats and demands when I pro-actively and voluntarily sought to correct my mistakes regarding their reporting. I am one of the few people that appealed the disclosure process penalties (at the risk of even higher penalties) and I eventually prevailed, resulting in the penalty assertions being withdrawn. My particular story is well documented and published on the web[1] within the context of related communication. The equivalent treatment, and worse, is what will be dished out to tens of thousands of Australians living in the US, and US-connected Australians living in Australia, under a badly implemented FATCA regime.

I now live back in NZ, no longer hold a greencard, and I have a spouse who is a NZ-resident American citizen. FATCA promises my spouse discrimination by either FIs (Financial Institutions), or the government, that will treat her differently because of her place of birth and US citizenship. She faces her privacy being violated by having her information and personal details involuntarily reported to a foreign government, and she faces possible forcible withholding of payments due to her by her NZ bank. She will face the possibility of confiscatory penalties being imposed on her by the US government for any inadvertent mistakes in her tax (and tax-related) returns that are highlighted by FATCA information exchange. Even if they never leave NZ territory, our children (the first of which is due next March) will automatically inherit US citizenship from their mother and will live with the same burdens that she does. I am the primary earner in our household; my assets are jointly held with my American spouse and therefore subject to the same involuntary information transfer to a foreign government under FATCA. My contribution to our joint assets is far greater than that of my spouse (who is a part-time school teacher) and yet they form the basis for the gargantuan penalties that may be assessed against her for failing to correctly comply with complex citizenship-based US reporting obligations.

1 Google documents (shortened link) – Published personal correspondence with IRS regarding non-US accounts - http://bit.ly/ONO5hY

I'm a New Zealander, but the issues I am describing will be repeated and magnified for tens of thousands of innocent Australians that have some form of relationship with the US. It is extremely important that the Australian government considers the drastic consequences for these people in its deliberations regarding FATCA.

These are just some of the considerations that contribute to the conclusion that the model IGA should not be adopted and that Australian FIs should only be allowed to comply with individual FATCA agreements strictly in accordance with current Australian law. The best course of action would be to put a renegotiated IGA on the table; one that meets the stated objectives of FATCA, offers equal benefits to the IGA parties, reflects international norms on personal taxation, and protects Australians from draconian US regulation that is completely contrary to Australian public policy. The rest of this submission elaborates on these issues in more detail.

2. The Question and the Answer

The subject of this consultation is the US Foreign Account Tax Compliance Act (FATCA), and specifically requests information on:

> *"...advantages and disadvantages of an intergovernmental agreement (IGA) between Australia and the US, based on the published US Model IGA, as an alternative to individual agreements between Australian financial institutions and the US Internal Revenue Service"*

To begin with, FATCA — represented by both individual FI agreements and the model IGA — should be recognised for what it truly is; a trade barrier that is being unilaterally imposed by one trading partner (USA) on another (Australia). As with all trade barriers, the choice is to meet the additional costs imposed or lose access to the market. The compliance burden is a cost that will initially be met by FIs, but will simply be passed on to individual consumers as banking fees or as reduced investment returns. This is the equivalent of a direct trade tariff, except that the benefits accruing to the tariff-imposing country are widely recognised as far less than the burden being imposed on the target country.

Given the seeming inevitability of FATCA in general and the wording of the consultation, one must assume that the Australian government is considering the question of:

- *"Whether it is in the interests of the Australia to adopt the model IGA?"*

The answer is unequivocally "no". The implementation of FATCA by individual FI agreements and the IGA alternative both represent bad policy and are counter to the interests of Australia and Australians. Despite this, the obviously least-bad option is that of individual of FI agreements.

This conclusion is reached by looking at what the goals of the Australian government should be seeking when answering the question; those goals are:

- Retaining access to the US financial markets for Australians that want it
- Minimising the aggregate of resulting burden of compliance that is imposed on Australians
- Distributing the additional burden across individual Australians in the most equitable fashion
- Ensuring that Australian FIs and the Australian government comply absolutely with the letter and intent of current Australian law

The rest of this document elaborates on the reasoning for why leaving FIs to enter (or not enter) into individual agreements best meets these goals, why it is the right answer to the question posed, and therefore why the Australian government should not enter into a model IGA. Importantly, this answer does not require altering of the protections for Australians that are rightly enshrined in Australian law.

Unfortunately, the two options on offer in this consultation do not allow for answering the broader question that could be asked about how to meet the stated goals of FATCA, support Australian tax compliance objectives, protect Australians, comply with domestic law, and enhance international tax transparency. I have answered this question later in the document (section 4) to illustrate the missed opportunity represented by the narrow-minded options that have been unilaterally thrust towards Australia by the US government.

3. The case against adopting the model IGA

3.1. Compliance with individual FI agreements does not contravene Australian law and therefore an IGA is not required

The Australian Bankers Association has publicly stated[2] that complying with FI agreements conflicts with the Racial Discrimination Act 1975 (RDA), as it would require banks to discriminate against people based on their citizenship and/or national origin. According to individual FI agreements, US citizens would be required to have their information transmitted to the IRS, and to have their accounts closed if they did not agree to have their information transmitted. The ABA has taken the narrow, and incorrect, view that this requires FIs to unlawfully discriminate to achieve this outcome. The supposed conflict with Australian law has been suggested as a key reason as to why the Australian government needs to sign an IGA to allow FATCA to be implemented. This is simply untrue.

The reality is that FIs do not need to unlawfully discriminate against groups of people in order to comply with an individual FI agreement. What FIs need to do is to treat all of their customers the same way and without discrimination. This means that any person dealing with a FATCA-compliant FI would have their FATCA-required information captured and transmitted to the IRS. This includes their personal details, citizenship status(es), rights-of-residence, account balances, and income details. The failure of any customer of a FATCA-compliant FI to provide the necessary waivers and consents for this transmittal to occur would face account closure, again without discriminating against any group of people. How the IRS deals with the information transmitted about non-US-Persons would be up to them. Whether they process it, store it, or destroy it is outside the control of the FI and therefore the FI is not responsible for the resulting discriminatory treatment.

Under individual FI agreements, the information of all the “everyday” Australians with accounts at a FATCA-compliant FI will be transmitted to the IRS. But this is a natural consequence of those individuals choosing to participate in a financial market that requires them to provide their details to the foreign government that dictates the policies in relation to that financial market. Any Australian that does not wish to submit to the loss of privacy required will be free to move their business to non-FATCA-compliant FIs. The desire of many Australians to maintain their privacy will create enormous market demand for non-FATCA-compliant FIs and their services. This will simply form part of the competitive market dynamic for FIs operating in Australia and will influence commercial decisions that FIs will make in determining their market strategies.

2 Australian Bankers Association – *“Submission on FATCA - 2010-60”* - http://issuu.com/anthonypquinn/docs/aba-fatca-2010-60

3.2. *The model IGA does not reduce aggregate compliance costs compared with individual FI agreements*

There is a notion that the model IGA will somehow reduce costs to FIs (and therefore the Australian public) compared with individual FATCA agreements. The Australian Bankers Association has supported this notion in publications relating to FATCA, stating:

> *"An IGA will not only reduce the compliance burden for all financial institutions in Australia, including the self-managed superannuation funds, but will also significantly reduce the impact on customers of FATCA identification and reporting to the US authorities."*[3]

This position is dubious. The expense incurred by FATCA is in the people, processes and technology required to capture additional information about their customers and report that information. The model IGA simply causes the information outputs to be reported to the Australian government rather than the US government. The IGA also employs different and less efficient mechanisms (see section 3.4) in defining which FIs will have FATCA reporting obligations compared with individual FI agreements.

While the withholding requirements under the model IGA differ from the individual agreements the net burden is unchanged. Under the model IGA FIs will still need to implement withholding mechanisms and withhold against Non-FATCA-compliant FIs. The actual degree of withholding will be the same under both regimes as parties (individuals, companies, FIs etc) that would be subject to withholding will simply avoid dealing with FATCA-compliant FIs.

Under any variant of FATCA, the primary drivers for aggregate FATCA-related costs on Australians will be the total number of Australian FIs with FATCA reporting obligations, and the total number of customers for those FIs. Each such FI will incur initial and ongoing costs for establishing and maintaining FATCA compliance systems. Each customer for such an FI will incur the ongoing cost of FATCA-related screening and reporting that each will be subject to. The smaller each of these numbers is, the smaller the aggregate cost will be. I suggest that under individual FI agreements the consumer demand for non-FATCA-compliant FIs will reduce both the number of FIs with FATCA reporting requirements and associated customers, resulting in a lower aggregate burden compared with the model IGA.

3.3. *Individual FI agreements distribute burden more equitably across individual Australians*

Ultimately, all the various burdens associated with any variant of FATCA will fall on individual Australians. Compliance costs that are incurred by FIs will be passed on to individual Australians in the form of bank fees and increased bank margins subtracted from individuals' investment returns. There is a "privacy burden" that will be met by individuals that are required to have their personal information transmitted to a foreign government. For some Australians there will be the burden of having severe financial penalties imposed upon them by the IRS. Which individuals carry these burdens, and to what degree, is a very important consideration for deliberations regarding FATCA.

The model IGA would distribute the burdens inequitably across individual Australians. Under the model IGA, it is likely that many more Australian FIs will be performing FATCA reporting and passing the compliance costs to their customers. Most Australians will pay increased banking fees to cover these costs, and the likely dearth of non-reporting FIs will mean that individuals will have little choice in the matter even if they have no desire or need to access the US financial system.

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3 Australian Bankers Association – *"Welcome development on FATCA"* - http://www.bankers.asn.au/Media/Media-Releases/Media-Release-2012/Welcome-development-on-FATCA

Also under the model IGA, there will be enormous burdens falling on:

- Australians that have emigrated from the US
- Australians that have acquired US citizenship from their parents.
- Australians that are living or working in the US

These are the people that will face enormous penalties from inadvertently being out of compliance with complex and little-understood US laws. In 2003 it was estimated that there were 65,200[4] Australian expatriates living in the US, and in 2006 it was estimated that there were 61,720[5] US-born Australian residents. Accounting for the inevitable growth in these numbers since they were recorded (and adding in others with different forms of US connection) there would easily be 150,000 Australians who today would fit "US Person" criteria. I would conservatively estimate that at least two thirds of these people would unknowingly have significant non-compliance with US tax and tax-related laws. This is driven by the plethora of US reporting obligations that are triggered by such people's ordinary Australian financial affairs, and the near-absence of knowledge in these communities of these obligations. I would also estimate of the typical financial sanctions that they could expect to have imposed on them (based on my own personal experiences) would be in the tens of thousands of dollars, and for some people much more. This figure is what they could reasonably expect from *voluntarily* correcting their previous non-compliance. Being notified of non-compliance due to their information being transmitted to the IRS under FATCA would result in far greater costs.

Under individual FI agreements, the various burdens would fall exclusively on the individuals that specifically wish to deal with FIs that access the US financial system. The benefits of access to the US financial system will accrue to those people, as will the privacy costs, and the increased service costs passed on to them by the FI. Individuals for whom these costs outweigh the associated benefits will migrate to non-FATCA-compliant FIs for their services. This alignment of costs and benefits is ideal for an efficient and competitive Australian financial system, as individuals make choices that suit their needs, and the FIs choose whether to be FATCA-compliant based on the consumer demand that results from this.

A model IGA would externalise these costs away from the individuals to which the benefits accrue and so distort market forces. Australians with US connections would be far more exposed to involuntary FATCA reporting by the FIs and Australian government, and the disproportionate penalties that would result.

3.4. The model IGA will distort the structure of the Australian financial services sector

Under a model IGA, all Australian FIs will be "FATCA compliant" but divided into Non-Reporting FIs (as defined by Annex II, and those fitting deemed-compliant criteria) and Reporting FIs (every other FI). This creates a situation whereby all FIs will have no choice about whether to be exposed to FATCA-related burdens; the decision will be forced upon them. The lack of choice will correspondingly be extended to individual Australians. Whatever the perceived cost-reductions are of having Non-Reporting FIs carved out by the model IGA, they will very possibly be outweighed by the inefficiencies of artificially imposed constraints upon the entire financial sector. An equitable distribution of FATCA-related costs across individuals and the resulting competitive market forces should be the primary driver in shaping the Australian financial services sector. The driver should not be the arbitrary decisions of a governmental agreement, particularly one where the decision-making is dominated by the interests of a foreign government.

Under any variant of FATCA, FATCA-compliant FIs across the world will avoid significant dealings with non-FATCA-compliant FIs. This is due to the withholding that FATCA-compliant FIs will be

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4 Australian Bureau of Statistics - *"Australian expatriates in OECD countries"* - http://www.abs.gov.au/AUSSTATS/abs@.nsf/bb8db737e2af84b8ca2571780015701e/3cf3335edc1a3f7fca2571b0000ea963!OpenDocument

5 Australian Department of Immigration and Citizenship - *"The United States of America-born Community"* - http://www.immi.gov.au/media/publications/statistics/comm-summ/textversion/usa.htm

obligated to perform with respect to payments to non-FATCA-compliant FIs. This will inevitably result in two side-by-side worldwide financial systems. Under individual FI agreements, Australian FIs will have to choose between serving consumers that value their privacy and lower fees, and customers that are willing to take on additional burdens to access the US financial system. They will also have to choose between access to the international FATCA-compliant financial system and the international non-FATCA-compliant financial system. Given this appropriate distribution of burdens across individuals and corresponding consumer demand, a balanced mix of FATCA-compliant and non-FATCA-compliant FIs will exist. Consequently, Australians will have an efficient market-driven mix of services through which they can access each of the two international financial systems.

3.5. *The model IGA discriminates against people in violation of Australian public policy and conflicts with international norms regarding taxation*

The Australian government has the power to enter into an agreement based on the model IGA and pass enabling legislation to support it. If the Australian government were to do this, it would be an explicit subversion of the Australian Racial Discrimination Act of 1975 (RDA). The government would be specifically enabling and institutionalising discrimination against a group of Australians based on their national origin and citizenship.

That banks cannot comply with FATCA agreements by specifically discriminating against US citizens is a natural consequence of good domestic public policy (RDA) interacting with bad extra-territorial policy (US citizenship taxation laws). The RDA exists because discrimination against individuals based on certain criteria such as citizenship and national origin is abhorrent to Australian values. It is excellent public policy and it should remain in force even if it may seem inconvenient to a number of bankers. As stated in section 3.1, this policy is does not prevent FIs from complying with FATCA FI agreements, it just prevents them from discriminating against people in the process of doing so.

Furthermore, citizenship-based taxation by the US flies in the face of international norms with respect to the taxation of individuals. International convention, and Australian public policy, is to tax individuals primarily based on residence. This US policy also infringes on the Australian government's exclusive sovereign right to tax people within its territorial jurisdiction, and conflicts with the Australian government's obligation to protect Australians from questionable policies of foreign governments. As such, this policy should not receive any support — either explicit or implicit — from the Australian government.

3.6. *The model IGA exposes Australians to ruinous sanctions that are contrary to Australian public policy*

US tax (and tax-related) policy is rife with draconian penalties for inadvertent non-compliance that are completely disconnected from any related tax liabilities or any reasonable assessment of wrongdoing. One of the most egregious examples is that of form TDF 90-22.1, the “FBAR”, that is required by the IRS from individuals with accounts outside of the US. Many Australians with US connections are required to file these forms and are not even aware of their filing requirement. An Australian born in Australia to a US citizen parent has a life-long obligation to annually report the existence of their Australian assets to the IRS. The penalties for non-compliance can be 300%[6] of the asset value, or $10,000 per year even if considered “non-wilful”. The actual amount imposed in any case is at the arbitrary discretion of the IRS, and is unrelated to whether there is any unpaid tax liability. The same information is also required on a separate and duplicative report (form 8938) that incurs a one-off $50,000 per year penalty for failure to report. The same information is required to be summarised yet again on form 1040, the US federal tax return. The total penalty exposure of such Australians is enormous.

6 FBAR form - *page 8* “penalties” section (50% per year, for up to 6 years) - www.irs.gov/pub/irs-pdf/f90221.pdf

Compliance with these US international reporting obligations by people with US connections is exceptionally low. In the case of FBARs there was 390,000 filings in 2008[7] out of population of international taxpayers that measures in the millions; 6 million US citizens living overseas and 1.1 million new immigrants annually to the US. Low compliance amongst these people who inevitably trigger reporting obligations is due to the complex nature of the US tax system and the near absence of communication about the requirements from the IRS in relation to the affected people. For example, the FBAR requirement has been missing from most informational guides[8,9] for such people.

US policy is to treat errors in US domestic tax reporting very leniently and non-US tax errors incredibly harshly. For example, an inadvertent failure to correctly report US domestic interest attracts an accuracy-related penalty of 20% of tax due, whereas an inadvertent failure to report non-US interest and the existence of the account can bring penalties up to 50% of the *account balance, per year*. The actual amount is subject to arbitrary (and sometimes whimsical) determinations of "wilfulness" by the IRS. The US government has used these harsh penalties as a mechanism to encourage compliance as an alternative to the compliance mechanisms of automatic information gathering available within their domestic financial system. In contrast, Australian tax policy relating to individuals with non-Australian accounts does not impose massive one-off, or percentage-of-balance penalties. They penalise the amount of unpaid tax due and allow for 80% reduction of that penalty where there is voluntary disclosure of non-compliance.

Harsh US penalties are not limited to only having Australian assets and bank accounts. For example; an Australian citizen and resident holding a US greencard that owned a small Australian business, and was the beneficiary of an Australian family trust would be subject to many thousands of dollars in IRS penalties for inadvertently failing to comply with the complex US reporting requirements for *each* of these relatively mundane aspects of their life.

Since 2009, common practice by the IRS has been to coerce "voluntary disclosure"[10] from people who have not been aware of such reporting obligations, by running campaigns threatening these draconian penalties. People stepping forward were required to forfeit typically 20-40% of their assets under the threat of even higher penalties. These people include US-connected Australians both in Australia and the US. I have personally been subjected to this policy during my time as a temporary immigrant to the US (as mentioned in section 1). That I had the penalty assertions withdrawn by arguing my case is irrelevant; it was a terrifying process that no-one should be subjected to. My successful appeal represents a tiny minority of the cases in which people in my situation were involved, with anecdotal evidence indicating most of these people paid the "voluntary" penalty under the threat of assertion of full penalties if they appealed.

Through FATCA the US government is seeking to have the equivalent automated information gathering at the international level as they do at their domestic level, but without relenting on the disproportionate penalties that will result from the inadvertent compliance failures that will be identified. This combination of policies is grossly unfair and discriminatory towards US connected Australians who necessarily have Australian tax affairs; e.g. Australians who have immigrated to, or emigrated from, the US. It is unconscionable that the US government is choosing to act with such little regard for those people who will be affected in this unbalanced system.

Under the model IGA, these harsh US policies and the inappropriate combination with automatic reporting would be specifically enabled and institutionalised by the Australian government, and the victims would be US-connected Australians. This is aggravated by the fact that that US policies towards penalisation of inadvertent reporting failures are clearly contrary to Australian public policy.

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7 US Treasury – 2007/2008 report FBAR compliance (shortened link) – Page 16 - http://bit.ly/PJhrPI

8 IRS - *"Publication 519 (2011), U.S. Tax Guide for Aliens"* - http://www.irs.gov/publications/p519/index.html

9 IRS - *"2008 Tax Guide for U.S. Citizens and Resident Aliens Abroad"* - www.irs.gov/pub/irs-prior/p54--2008.pdf

10 IRS – *"Questions and answers regarding the 2009 Offshore Voluntary Disclosure Program."* http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers

Individual FI agreements and the resulting substantial Australian non-FATCA-compliant financial system will at least allow Australians to be protected from these policies. As with other privacy-conscious Australians, when faced with FI requests for consent to transmit their personal information offshore these people will instead migrate to the non-FATCA-compliant FIs and the lower burdens they represent.

3.7. *Signing the model IGA would be submitting to coercion in the face of unilateral imposition of trade-barriers*

In 2005 the Australia-USA Free Trade Agreement went into effect. It was intended to enhance market access and trade for both Australia and the US, and specifically included financial services within its scope. Also, both Australia and the US are participants in the negotiation of the Trans Pacific Partnership Agreement that has similar goals to the FTA amongst a wide range of countries. It should be considered offensive by Australians that, with this shared history of good faith and mutual cooperation on free trade agreements, the US government has now unilaterally enacted a significant trade-barrier against Australia in the form of FATCA. A previous agreement with the US government would appear to be worthless if the benefits that are derived from it are outweighed by the unilateral imposition of greater costs on Australians only a few years after concluding that agreement.

The supposed benefits that might accrue to Australia from the model IGA stem from the prospect of reciprocity on the part of the US government. The promises of US government reciprocity in information exchange in the model IGA are vague and lack credibility. They certainly do not meet the standard expected of a mutually beneficial international agreement where the commitments demanded of Australia are concrete, substantial and subject to specific timelines.

The signing of the model IGA would simply compound the overall issue represented by FATCA as a whole. The model IGA is little more than a “take-it-or-leave-it” agreement and the adoption of which would amount to submitting to coercion. This is antithetical to good faith negotiation and mutual benefit that international agreements should be founded on. That the US government has unilaterally enacted FATCA is bad, that they are attempting to coerce the Australian government to sign an IGA to allegedly limit the costs of FATCA is appalling. If the Australian government adopts the model IGA then it will simply be indicating to the US government that they same approach will work in future in other matters, and the US government will most likely oblige by repeating the approach. This will inevitably not be to the benefit of Australians.

4. A missed opportunity: An IGA that balances the interests of both countries

There is a strong case for an agreement allowing automatic information exchange between countries such as Australia and the US to assist with tax administration of each country. Unfortunately the model IGA is deficient in so many areas that it should not be seriously considered. However, it is possible to have such an agreement that does not have the enormous downsides of FATCA in general, and the model IGA in particular. This section outlines what an appropriate agreement would look like.

A suitable agreement would seek to:

- Support the appropriate administration of taxes by both state participants in the agreement
- Allow for mutual and equal benefit from state participants in the agreement
- Avoid conflicts with common domestic anti-discrimination policies
- Reflect international norms regarding personal taxation
- Ensure penalty regimes are moderated to:
  - eliminate domestic policy conflicts; and
  - address disproportionate effects on individuals; and
  - recognise the equivalence of automatic international reporting to automatic domestic information reporting

Correspondingly, a suitable agreement would have the following features:

- Be written in partnership, not unilaterally imposed by one country on another, and with equal benefits, privileges and obligations
- Exchange information only on the *residents* of the other country and does not discriminate on individuals' *citizenship, national origin* or *right to reside* in relation to any country
- If information is transmitted about an individual, then the receiving state must be very specifically limited in how it can act on that information. For all the financial affairs of an individual that *is currently residing, or has ever resided, in that country* the receiving government should be:
  - limited to imposing only:
    - taxes that would be imposed on equivalent domestic income sources; and
    - penalties that would be imposed on equivalent domestic income sources; and
    - penalties that would be proportional to the amount of tax;
  - and specifically be precluded from imposing penalties that:
    - relate to reporting the existence of something other than income (e.g. an asset, or company); or
    - are a one-off penalty unrelated to the amount of tax due; or
    - are a penalty that is proportional to something other than tax due (e.g. an asset value)
- Individuals should be notified of the specific information being exchanged about them, before it is exchanged
- Individuals whose information is transmitted must also be specifically notified of the limitations placed on the use of the information to prevent that individual being coerced into "voluntarily" paying amounts to settle allegations.

Yours sincerely,

[Name withheld]