'False Positives' in FATCA Data May Hamper Enforcement

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Information reported to the IRS under the Foreign Account Tax Compliance Act likely includes that of many unidentified individuals who are not U.S. taxpayers, potentially limiting the data's value, according to practitioners familiar with the issue.

FATCA requires foreign financial institutions to submit information to the IRS — either directly or through their local government — about account holders who are U.S. taxpayers or recalcitrant, meaning they have not proved to an FFI that they are not U.S. taxpayers. But according to Michael Plowgian of KPMG LLP, formerly an attorney-adviser in the Treasury Office of International Tax Counsel, as FATCA was being developed, the IRS was concerned about FFIs potentially reporting information about recalcitrant account holders who are not U.S. persons or taxpayers.

Plowgian said the IRS is now receiving data files that likely contain many of these so-called false positives and will have to sift through those data as part of its enforcement efforts.

Ross McGill of TConsult Ltd., near London, said the IRS is getting enormous amounts of data under FATCA but that much of the information will be irrelevant and hard to sort through. Denise Hintzke, global FATCA tax leader at Deloitte Tax LLP, said she wondered what the IRS would do with all the data it is receiving under FATCA.

The practitioners agreed that false positives could limit FATCA data's value to the IRS, noting that the IRS has yet to receive most of it.

The IRS previously mentioned false positives in a November 2015 summary of a FATCA roundtable it held with industry stakeholders. Under a listing of the most significant compliance enforcement challenges the IRS may face, the document said, ''Industry noted that over-reporting, over-withholding, and misinformation could make it difficult for the IRS to use the information it is receiving as intended, and may lead to false-positives.''

In an October 18 statement to Tax Analysts, the IRS said it ''expects that FFIs will perform the requisite due diligence obligations to identify and report on solely U.S. accounts.'' The IRS did not say whether that expectation was being met but expressed a preference: ''The IRS does not want to receive information regarding non-U.S. account holders.''

You Can't Always Get What You Want

Although the IRS did not mention any strategy for identifying false positives, it outlined a process for clearing them. The agency said that if it believes it has received information about a non-U.S. person, it will contact the appropriate competent authority or FFI to confirm the error and then coordinate to ensure the information is not used.

''If the information indeed related to a non-U.S. person,'' the IRS continued, it would ''request that the sender void the record [as] described in IRS Publication 5124, *FATCA XML v1.1 User Guide*.'' Any FFI, regardless of its jurisdiction's intergovernmental agreement with the United States, can follow those corrective steps if it discovers that an account holder is not a U.S. person, or that the account itself is not reportable, the IRS said.

FFIs are required to enforce penalties — including 30 percent tax withholding on qualified income — against account holders who have failed to establish that they are not U.S. taxpayers, McGill noted. FFIs in the jurisdiction of an IGA signatory are relieved from having to enforce the penalties, McGill said, with the catch that the FFI must report those account holders as recalcitrant. (Prior coverage: *Tax Notes*, Oct. 17, 2016, p. 361.)

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FFIs thus face an incentive to overreport, McGill said. He added that financial institutions have varying resources to devote to regulatory compliance, requiring a ''pragmatic, risk-based approach'' that balances the demands of multiple laws — a particular challenge for small and medium-size entities, he said.

Plowgian concurred that FATCA's structure encourages FFIs to err on the side of reporting an unidentified account holder as recalcitrant, on the theory that failing to report a U.S. taxpayer would be riskier than reporting a false positive.

A key FATCA requirement is that FFIs report whether or not there are so-called U.S. indicia tied to a recalcitrant account holder, which must themselves be reported, including records of a U.S. birthplace, citizenship or lawful permanent residence status, or a U.S. phone number or address.

Hintzke said the IRS should be able to compare account holder records against its own databases of U.S. taxpayer information relatively easily. However, McGill pointed out that many reported account holders will lack U.S. indicia.

An FFI's know-your-customer and anti-money-laundering databases may intimate that an account holder has U.S. indicia, McGill said. But many other account holders simply never respond to — or actually see — requests for information regarding FATCA, and a large proportion of those individuals may have no overlap with IRS databases, he added.

That would limit the cross-referencing Hintzke envisioned. Hintzke herself questioned how the IRS will prioritize indicia versus non-indicia cases of recalcitrant account holders.

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McGill noted that any false positives would be FFI accounts that predate FATCA's 2014 effective date because persons opening accounts with FFIs since then have been required to fill out some variant of Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)."

McGill also argued that a non-responsive account holder is highly unlikely to be a U.S. taxpayer trying to hide because tax avoiders with even minimal sophistication would know that their information will be shared with the IRS if they do not respond to FATCA inquiries. ■