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States Take Note: FATCA Is Here

by Penelope Lemov | July 17, 2014

Finance

After years of planning, the Foreign Account Tax Compliance Act is finally in effect. How will it affect your state?

Customers use the ATM at a bank in China. AP/Greg Baker

It's July and it's a tax season of sorts: As the 2014 legislative sessions draw to a close, all the new tax laws passed are being implemented this month. Even though most states have cut taxes -- namely corporate taxes -- some may still see a revenue boost if they have an income tax. That's because the Foreign Account Tax Compliance Act, or FATCA, is now officially in effect.

FATCA is what *Forbes* contributing columnist Robert Wood calls "America's global tax law." It warrants the tagline since it requires foreign banks to report data on American accounts that have more than $50,000 in them. Congress enacted FATCA -- which is one "T" shy of spelling out FAT CAT -- to make it more difficult for U.S. taxpayers to conceal assets held in offshore accounts and shell corporations, thus making it easier for the federal government to recoup tax revenues.

But what's revenue for the feds, may also be money in the coffers for states. Wood recently elaborated on how the global tax law might affect states. "If someone is encouraged to report income to the [Internal Revenue Service]," he said, "they are likely to include that income on their state tax return as well."

When the Joint Committee on Taxation worked on the law in 2010, it estimated that FATCA could raise about $800 million a year in revenue. So far, 80 countries and 77,000 financial institutions have registered. When the IRS starts collecting FATCA revenue this month, what should states understand about it?

Roberton Williams, the Sol Price Fellow at the Urban-Brookings Tax Policy Center, highlighted a few key issues:

--Whether the money earned in these accounts is subject to taxation depends on a number of factors. One example, there may be tax credits for taxes paid overseas.

--This is an immense undertaking because, to start, the IRS doesn't have authority over foreign banks and had to sign agreements with foreign countries in order to get foreign banks to comply.

--States have different rules about taxing out-of-state income. Typically, income is taxable to the individual no matter where it's earned. But states have their own rules that have little quirks. Some, like New Hampshire, levy taxes on investment income but not on earned income.

--There's no guarantee the IRS will share its FATCA information with the states.

--Depending on a state's rules and rates, some states will see more revenue than others.

--This is a new potential source of revenue. State revenue agencies should look at and advise their governors and legislatures about what it is going to mean, what issues they might want to deal with. Adjustments may need to be made or a state might be happy to leave things on autopilot.

Williams also noted that while some people are hiding accounts overseas intentionally, some just didn't know they were supposed to report the accounts. Americans working abroad, he said, may have retirement accounts in another country and didn't necessarily think of those as foreign bank accounts.