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Mr. Putin, Tear Down That FATCA

Russia remains in the doghouse these days over its actions in Ukraine. On top of everything else, there's the Crimean election result fiasco. In the meantime, Russian oligarchs are reportedly using tax havens like mad, behaving as if it were the 1980s.

And yet, at least some things could change dramatically in the near future. Russia still hasn't climbed aboard the hurtling freight train that is FATCA—the Foreign Account Tax Compliance Act. It could be more significant than you might think. As noted in How Russia Inc. Moves Billions Offshore, Russia's richest businessmen use foreign companies extensively, often in tax haven countries.

But the potential loss of the U.S. markets will still smart. In a way, that's what Russia is facing. Most other nations—more than 50 now—have signed up to comply with FATCA under one of several forms of agreements with the U.S. A complete list is available at this FATCA – Archive. The list includes countries famous for bank secrecy, such as Switzerland and the Cayman Islands.

And while China hasn't yet inked a FATCA deal, China has pledged to fight tax evasion. Russia too would seem like a logical fit. Why has Russia grown colder to the idea? It's not entirely clear whether the U.S., Russia or both are turning down the temperature. A few months ago it looked as if even Russia would sign up. After all, Russia like other countries was negotiating information-sharing agreements with the U.S.

However, once Russia annexed Crimea and fueled movements in eastern Ukraine, the U.S. Treasury stopped talking about a deal with Russia. As FATCA's July 1 deadline draws near, Russian banks may worry that the cost of U.S. investments will go through the roof. The U.S. imports billions of dollars in goods from Russia, and export billion of dollars in goods to Russia.

Russian institutions do not want to be left behind. A requirement that banks have to start withholding could spread like cancer, particularly given the complex web of relationships global banks have. Most foreign nations and foreign banks are keen to hand over American account holders to the feds. In return, the foreign nations and banks get unfettered access to U.S. capital markets.

Foreign banks must hand over the details of American account holders with over $50,000 on deposit. Institutions that fail to comply could effectively be frozen out of U.S. markets entirely. Eventually, the banks would be forced with withhold a 30% U.S. tax on every transaction. And those consequences for any nation are big.

That's why the U.S. Treasury Department has signed up so many nations. With prosecutions, summonses, and the IRS voluntary disclosure programs, the IRS is getting quicker, better and more complete information than ever. And FATCA will expand it like a fire hose.

After foreign institutions identify U.S. account holders, FATCA requires the institutions to impose a 30% tax on payments or transfers to any who refuse to step up and get into full U.S. compliance. The withholding applies to stocks and bonds, including U.S. Treasuries. Some previously owned securities are exempt from withholding. In general, though, previously owned stocks are not exempt.

For the time being, it looks as if Russia will be left out. And while legal challenges to FATCA are being mounted, that may put Russia into an odd position in the world.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.