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How to curb tax evasion the American way

FATCA implementation and lessons for Nigeria

By Taiwo Oyedele

For Nigerians who love to give birth to their children in the United States, it is time to have a rethink and weigh the perceived benefits of US citizenship against the associated tax burden of that passport.

To a great extent countries the world over, whether developed or not, rely on revenue from taxation in one form or the other to finance their governments regardless of whether they are endowed with natural resources or not.

Each country, being a sovereign state, is at liberty to set rules imposing taxation on both natural and corporate persons whether resident in that territory or not, to the extent that they have economic connections with such country.

Like Nigeria, the United States is a constitution-based federal republic divided into states and one federal district. All the levels of government, from federal to state to municipality, have authority to levy and collect tax. Resident corporations, citizens and resident individuals are taxed based on their worldwide income. Unlike many countries, US citizens and permanent residents (i.e. green card holders) are subject to tax in the United States even if they live abroad indefinitely until the green card is relinquished. This means all income earned at home and abroad must be declared for tax purposes.

Parting with money is never easy, especially when there is no direct exchange of value as is the case with tax payments. As a result, a good number of Americans stack their income and wealth abroad without reporting them to the US Internal Revenue Service (IRS). The US Congressional Subcommittee on Investigations estimated that these tax dodging schemes cost the Treasury as much as USD 100 billion annually.

As part of the "Hiring Incentives to Restore Employment (HIRE) Act" signed on March 18, 2010 aimed at reviving the US economy, the Foreign Account Tax Compliance Act (FATCA) was introduced to ensure the disclosure of assets and income by US persons held with foreign financial institutions (FFIs).

An FFI is any non-US entity that accepts deposits in the ordinary course of banking or similar business, or holds financial assets for others. It also includes investment advisors conducting investment activities on behalf of customers; or entities that are managed by other financial institutions, and whose income is primarily attributable to investing in financial assets as well as insurance companies that issue or are obligated to make payments with respect to cash value insurance or annuity contracts. Examples of FFIs include banks, insurance companies, securitisation vehicles, hedging centres, intermediary holding companies, retirement schemes, private banks, stock brokers, trustees, captive insurance companies, finance companies and treasury centres.

FATCA mandates all FFIs who receive or make payments to any US person to collect and disclose certain information to the IRS. The Act requires such organisations to register and/or enter into an agreement with the IRS to receive a Global Intermediary Identification Number (GIIN). This number serves as the evidence of compliance when dealing with others to prevent the 30% withholding required to be deducted from payments due to a non-compliant account holder, payee or a foreign entity effective from 1st July 2014. Failure to withhold when required transfers the liability to the person making the payment plus penalties and interest. Also, a US company for the purpose of FATCA is any company owned at least 10% by US citizens or permanent residents.

As a payee, failure to provide appropriate documentation could result in being subject to the 30% withholding tax on payments received. The FATCA rules apply to both third party and inter-company payments so entities within the same group are not exempted. Generally, payments liable to the deduction include interest, dividend or dividend equivalents, certain swap payments, certain foreign exchange transactions, certain payments on cash pooling arrangements, annuities and collateral arrangements among others.

All FFIs in Nigeria including banks need to put in place processes to identify US persons, collect the relevant information, report to the IRS and deduct 30% from non-compliant persons or be liable. To fulfil this obligation, affected entities need to identify the gaps between current documentation process and information required under FATCA. For instance, it will no longer be sufficient to ask customers about their citizenship when opening a bank account but to specifically ask if they are US citizens or green card holders. This is because a customer may hold dual citizenship including that of the United States and simply state their other nationality. Based on media reports, thousands of US citizens have renounced their citizenship to avoid the obligations. Unfortunately where you choose to take this option, you will not be absolved of tax liabilities accumulated before that date. For Nigerians who love to give birth to their children in the United States, it is time to have a rethink and weigh the perceived benefits of US citizenship against the associated tax burden of that passport.

The adoption of the reporting requirements under FATCA could raise legal issues such as data confidentiality. Also deduction of 30% withholding tax by an FFI in Nigeria may be challenged legally by the customers. To avoid this, a country may enter into an inter-governmental agreement (IGA) with the United States for the implementation of FATCA. The IGA helps remove domestic legal barriers to compliance and lowers the cost and burden of implementation on affected entities. In addition, the United States will exchange information with countries that have entered into an IGA. This may also indirectly assist in the discovery of illicit funds and proceed of fraud stacked in foreign accounts.

Nigerian government has been slow in responding to this new development even when it is obvious that we technically have no choice but to comply. Many countries worldwide have entered into an IGA for this purpose. Based on the latest information provided the US Treasury, Nigeria is not one of the countries that have concluded an IGA with the United States as of 13 June 2014.

Intuitively, FATCA presents an opportunity for tax authorities in Nigeria to collect useful information from taxable persons in Nigeria to improve tax compliance. This will have a positive impact on tax revenue for both the federal and state governments in view of the high level of tax evasion in Nigeria. According to the minister of finance, 75% of registered companies are not in the tax net of the FIRS. At the states level, Lagos State with the highest compliance rate has about 8 million taxable persons but only about 4 million are in the tax net according to the state government. With this, one can only imagine the rate in other states.

Just as the United States introduced transfer pricing documentation in 1994 to address tax avoidance, which Nigeria has now adopted 20 years after, FATCA is designed to curb tax evasion. Given the high prevalence in Nigeria, hopefully it will not take another 20 years for Nigeria to implement FATCA.

Following the recent GDP rebasing, Nigeria's tax revenue to GDP ratio for 2013 is about 8% for all taxes and about 4% for non-oil tax revenue which is one of the lowest in the world compared to about 52% in France, 40% in the UK, 25% in South Africa, 23% in Ghana, and 17% the United States according to the Central Intelligence Agency. In per capita terms, this translates to about NGN38,000 per person in Nigeria compared to over NGN1.4 million per person in the United States.

On one hand, Nigeria must take steps to improve tax compliance including implementation of FATCA. On the other hand, taxpayers' money must be put to work for the benefit of all. Organisations that will be affected by FATCA need to assess their exposure and implement measure to achieve compliance.

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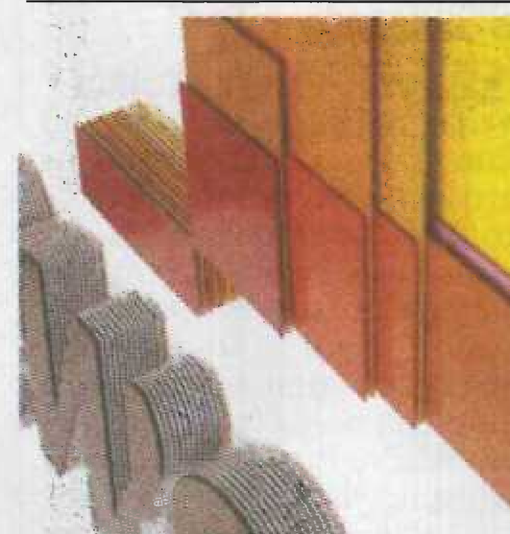

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