Expats Suffer More Collateral Damage

Americans who live or work abroad may enjoy many aspects of their cosmopolitan lifestyle, but Washington continues to make their financial lives miserable.

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A while back I wrote about the Foreign Account Tax Compliance Act, commonly abbreviated FATCA. As I observed at the time, the law imposed burdensome compliance requirements on foreign banks that have American accountholders in the name of hunting down U.S. taxpayers hiding assets in offshore accounts. By farming out some of its enforcement duties to foreign banks, the IRS hoped to catch cheats, but I predicted that in the process it was likely to scare foreign banks away

That is exactly what happened. Some banks started turning Americans away soon after the legislation passed; more of them took that step recently in advance of the regulations' July 1 effective date. Expatriates and their families are not the only ones affected; small and midsized American companies, too, have had trouble obtaining banking services overseas. Under criticism, the Treasury has argued that turning away U.S. accountholders will not allow a foreign financial institution to avoid FATCA altogether, though that has not made it much easier for Americans living abroad to find a bank willing to take their business.

Now, with little relief in sight, the headache is about to get worse. Not only are American expatriates having trouble finding foreign banks to serve them, they are now finding that American mutual fund companies don't want to serve them either.

Fidelity Investments and other domestic financial services companies have told American clients living outside the country that they are imposing new rules on their accounts. Americans living abroad will not be able to perform basic management functions on their brokerage accounts from outside the country – transactions like buying new mutual funds, switching their holdings from one fund to another, or rebalancing their asset allocations among funds they already own. Stephen Austin, a spokesman for Fidelity, pointed to "today's continually evolving global regulatory environment," but did not identify any specific issue that triggered the change, according to The Wall Street Journal.
Given foreign financial institutions' FATCA-fueled reluctance to deal with American customers, it is easy to lump this new problem under the umbrella of problems created by the law. But while FATCA may be indirectly to blame, it is almost certainly not the direct catalyst for this development. The problem for American mutual fund companies and their customers isn't really FATCA as such. Instead, it is the fear of tit-for-tat treatment by foreign governments.

Most countries apply tax laws and other statutes only to their own residents. If a German sets up permanent housekeeping in Iowa, Germany relinquishes the power to tax its citizen and will rely on American authorities to handle other related legal matters, such as protection against fraud. In contrast, the United States alone among industrialized countries insists that no matter how long an American lives in Dusseldorf, the American must continue to pay taxes to Washington. Expatriates also remain subject to a wide range of domestic laws, such as restrictions on commerce with sanctioned countries. None of this is anything new.

Notwithstanding this frustrating piece of American exceptionalism, for years U.S. citizens who moved abroad have been able to trade their mutual funds with most of the big investment houses as a matter of course. But now that America is aggressively prosecuting or extracting settlements from foreign banks for violating U.S. law, mutual fund companies fear that they will be targeted for equal treatment in turn. Since they don't wish to register their products in the nearly 200 national jurisdictions worldwide where an American customer might set up housekeeping, the companies have decided to simply tell American expats that they are out of luck.

This situation is yet another unanticipated consequence of the heavy-handed crusade against tax dodgers who have been hiding their assets from the Internal Revenue Service in secret overseas accounts. This is not to defend tax dodgers. But the collateral damage from hunting them threatens to affect hundreds of thousands, if not millions, of Americans who are living, and often working, abroad. In the government's haste to recover these lost funds, it seems more than prepared to make life difficult or impossible for Americans who have done nothing more nefarious than live outside the borders of the United States.

It would be nice if reason prevailed, and institutions again felt it was prudent to work with American customers living overseas. In the absence of change built on reason, however, Americans may need to engage in elaborate, and only somewhat effective, planning through trusts and business arrangements that will keep their mutual funds in onshore entities where they can be managed effectively.

Aggravating? Sure. But as long as FATCA and other regulations like it hold sway, Americans abroad will have to live with the far-reaching consequences of Washington seeking to impose its will anywhere it can get away with it.