Misleading Claims About U.S. Barriers to Iran-Europe Financial Ties

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Brief Analysis

Few people understand that Iranian banks do not live up to the standards U.S. agencies require of all foreign financial institutions, and that this shortcoming has nothing to do with the nuclear deal.

On April 25, following the first post-Implementation Day meeting of the joint P5+1/Iranian committee in Vienna, Deputy Foreign Minister Abbas Araqchi stated that all parties had approved the creation of a task force to address his government's complaints about sanctions removal related to the nuclear deal. This was the latest step in Iran's largely successful campaign to blame the United States for the various problems that continue to hinder its businesses, especially in terms of accessing the international banking system.

On April 15, Iranian foreign minister Mohammad Javad Zarif told reporters that Tehran and the EU "will put pressure on the United States to facilitate the cooperation of non-American banks with Iran." Visiting EU foreign policy chief Federica Mogherini was present at the joint press conference, and news accounts of the event implied that she agreed with Zarif, though she did not say so directly. The *Wall Street Journal* wrote, "The absence of large western banks to underwrite deals and set up broad financial links is stymying the delivery of concrete projects, [and] European officials fear this could spark a downward spiral of mistrust over the nuclear accord." Similarly, an Iranian business consultant told the *New York Times*, "If the situation doesn't change for the better -- banking, more deals -- for Iran this will be a growing risk for the deal." The paper also quoted European Parliament member Marietje Schaake complaining that "Europe is being held hostage by American policy...We negotiated the nuclear deal together, but now the U.S. is obstructing its execution."

Indeed, Washington has erected significant barriers to Western banks seeking to work with Iranian banks. Yet the reasons for this practice have nothing to do with the nuclear issue. In fact, some of the most significant obstacles are completely unrelated to any of the deep foreign policy differences between the United States and Iran.

THE TAX AVOIDANCE EXAMPLE

One of the most serious barriers that banks and insurance companies face when contemplating transactions with Iranian financial institutions is compliance with tax avoidance laws. The 2010 U.S. Foreign Account Tax Compliance Act (FATCA) places tough requirements on foreign financial institutions (FFIs) to report accounts of U.S. taxpayers. As the IRS guidance on the law explains, "FFIs that do not both register and agree to report face a 30% withholding tax on certain U.S.-source payments made to them." Agreeing to report means dealing only with FATCA-compliant FFIs. In practice, almost every financial institution in the world insists that its correspondents be FATCA-compliant because that is the only way to avoid the heavy withholding tax.

FATCA is hardly a secret: its long rollout was much commented on in the financial press, including Persian Gulf media. And when the legislation conflicted with local laws protecting bank secrecy, many countries worked with the United States to reach "intergovernmental agreements" (IGAs), which allow FFIs to report the required information to their home government instead of the IRS; if Washington has any questions about accounts that U.S. taxpayers hold with these institutions, it directs them to the government.

FFIs cannot credibly complain that FATCA represents extraterritorial overreach given the current international environment of hostility to perceived tax avoidance by multinational companies. Many European countries are in the process of implementing rules similar to FATCA, in line with the Global Account Tax Compliance program proposed by the Organisation for Economic Co-operation and Development. Such proposals have been supercharged by the Panama Papers, a trove of leaked documents from the law firm Mossack Fonseca reportedly revealing tax avoidance efforts by a wide assortment of financial institutions, government officials, and other individuals around the world. In a statement regarding the leak, the firm insisted that it fully cooperates with investigations of possible FATCA violations. And White House Press Secretary Josh Earnest has sung the praises of FATCA for protecting the United States against the type of foreign tax avoidance apparently detailed in the papers.

The IRS has good reason to worry about tax avoidance by American citizens or green-card holders with income or property in Iran, which they may not have declared because it could violate U.S. sanctions (one of the many examples of sanctions-related complications for ordinary people). Such individuals resident abroad -- including people born in the United States when their parents were studying there but who have never lived in America -- are often surprised to find they are liable to pay U.S. taxes on their worldwide income. While there is no hard data on the matter, many tens of thousands of U.S. citizens or green-card holders likely reside in Iran.

If Iran wants to protect the privacy of its financial institutions and citizens, it can do what many other governments have done: sign an IGA with the United States. Failing that, each Iranian bank will have to register with the IRS for a Global Intermediary Identification Number (GIIN) -- otherwise, every foreign institution that has financial dealings with them could face the 30 percent tax on U.S.-source payments. Thus far, only one Iranian bank has reportedly registered for and received a GIIN: the Hamburg branch of the state-owned Bank Melli Iran. Some other Iranian-owned foreign-incorporated banks may be covered by an IGA; those not covered or registered can expect great difficulties interacting with non-Iranian financial institutions, regardless of any action Washington takes on the sanctions front.

Indeed, FATCA has nothing to do with the nuclear sanctions and is most assuredly not directed at Iran alone. Neither the State Department nor the Office of Foreign Assets Control (which administers Treasury Department sanctions) has any say over how the law is implemented. Yet from the perspective of a foreign financial institution, FATCA is part of the U.S. policy mix that impedes transactions with Iran, as with any other non-FATCA-compliant country.

POLICY IMPLICATIONS

On April 21, Zarif told the *New York Times* that the nuclear deal "requires the United States to allow European financial institutions to have peace of mind for dealing with Iran." At a joint press appearance with Zarif the next day, Secretary of State John Kerry insisted, "The United States is not standing in the way, and will not stand in the way, of business that is permitted in Iran." Many people likely regard Kerry's statement as misleading because various agencies of the U.S. government -- though not the State or Treasury Departments -- do in fact stand in the way of Iranian banks gaining full access to the international financial system. Yet these barriers stem from the simple fact that Iranian firms are not following the same rules applied to all other foreign banks and insurance companies.

Therefore, rather than assuring Europeans they can have peace of mind in dealing with Iran, U.S. regulatory and tax agencies will continue to insist that EU financial institutions apply the same tough rules to their Iranian counterparts that they apply to all others. Observing those standards is a daunting task for Iranian banks, which are not yet up to the stricter international norms adopted during the years when their country was under nuclear sanctions. These new rules are very burdensome; major international banks spend billions of dollars implementing them. Newly confronted with all they must do, no wonder Iranian banks complain.

In a speech posted to his website on April 27, Supreme Leader Ali Khamenei argued, "On paper the United States allows foreign banks to deal with Iran, but in practice they create Iranophobia so no one does business with Iran." If Washington is worried that such sentiments will lead people to accuse the United States of not living up the nuclear deal, then the best defense is a good offense. Rather than implicitly accepting Zarif's formulation that the U.S. government has to reassure European banks, Washington should instead point out that if Iran wants to enjoy the fruits of the nuclear deal, it must join the rest of the world in implementing the tough standards adopted over the past decade regarding tax avoidance, financial reporting, money laundering, and other issues. The message should be clear: any financial institution that fails to implement those standards, no matter what country it calls home, will be under close U.S. scrutiny.

Patrick Clawson is the Morningstar Senior Fellow and director of research at The Washington Institute. ❖

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