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CHAPTER 1

BACKGROUND AND CURRENT STATUS OF FATCA*

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§ 1.01 FATCA OVERVIEW

The Foreign Account Tax Compliance Act, referred to as FATCA, is contained in Chapter 1471–1474 of the Internal Revenue Code of 1986 as enacted into law by section 501(a) of the Hiring Incentives to Restore Employments (HIRE) Act 2010. The total amount of the offset revenue was projected to be for the ten year period from 2010 to 2020 equal to $8.714 billion.[1]

FATCA was passed on the basis that "each year, the United States loses an estimated $100 billion in tax revenue due to offshore tax abuses."[2] Passage of FATCA thereby still loses an estimated $99 billion per year. However, FATCA may not be intended to close the U.S. revenue loss gap. Senator Levin stated that FATCA was intended to "force foreign financial institutions to disclose their U.S. account holders or pay a steep penalty for nondisclosure."[3] Unlike conventional withholding tax which is, in fact, intended to tax, FATCA is an *interim* measure

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[1] Joint Committee on Tax, Estimated Revenue Effects Contained in Senate Amendment 3310, the "Hiring Incentives to Restore Employment Act," under consideration by the Senate.

[2] Senate Permanent Subcommittee on Investigations, "Tax Havens Banks and U.S. Tax Compliance", Staff Report, July 17, 2008.

[3] HIRE Act, 156 Cong. Rec § 1745, § 1745 (daily ed. Mar. 18, 2010) (Statement of Sen. Levin).

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intended as a penalty regime to force foreign financial institutions to disclose private financial information to the IRS unilaterally. The Staff Report by Senator Levin's Subcommittee does not reveal what will be done with this information as the projections do not show FATCA raises any significant tax revenue annually.

Technically, FATCA is similar to other recent massive government technology programs which are described as "entirely reliant on cross-functional and cross-organizational collaboration across the user/customer and provider landscape, an effective and mature generation process, and well developed business, technical and human capital strategies. Achieving these goals requires multiple disciplines and, in many cases, multiple organizational elements. . . . It is a complex series of systems that must be seamlessly interconnected."[4] To date, no such technology system actually exists. Future costs to develop technology to facilitate a seamless and secure FATCA system are unknown. Insurance for potential FATCA liability claims is not yet available.

FATCA does not operate in a global tax vacuum. It is nearly impossible to comprehend fully its impact unless it is viewed in context. This introductory chapter will provide certain background information necessary to understand FATCA and make important decisions concerning FATCA adoption by any financial institution.

What are the benefits to the financial institution? What are the costs in terms of initial implementation and ongoing administration? How will customers or clients be impacted? Is customer financial information protected by foolproof cybersecurity? What civil, criminal, operational, employee, and customer or client risk exposures will result in complying with FATCA? What will be the cost and availability of insurance? What legal, accounting, or other consultants' opinions will be necessary to establish compliance associated costs?

§ 1.02 FATCA AND THE TAX GAP

On the heels of the UBS scandal and President Obama's campaign commitment to clamp down on offshore tax evasion,[5] FATCA was initially introduced as both a Senate and House bill respectively by Senator Max Baucus (Chairman of the Senate Finance Committee), Senator John Kerry (Senior Finance Committee member), Congressman Charles Rangel (Chairman of the House Ways and Means Committee), and Representative Richard Neal (Chairman of the Ways and Means Committee on Select Revenue Measures).[6] The Senate Finance Committee and the House Ways and Means Committee control congressional tax matters.

However, this effort to achieve international tax compliance was the product of

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[4] Next.gov, OP.ED: What Really Went Wrong with Healthcare.gov.

[5] G20, *Dec. of Strengthening the Financial System*—London Summit—available at http://www.g20.utoronto.ca/2009/2009ifi.pdf (accessed November 15, 2013).

[6] Holland & Knight LLP, "Foreign Account Tax Compliance Act (FATCA) means increased disclosure requirements, penalties and audit periods," Kevin E. Packman and Mauricio Damian Rivero, July 9, 2010.

numerous investigations and reports by the House Permanent Subcommittee on Investigations chaired by Senator Carl Levin. Senator Levin held hearings beginning in the 1980s regarding offshore tax evasion relating to a number of foreign accounts, which led to the enactment of FATCA in 2010.[7]

William J. Wilkins, Chief Counsel for the IRS, testified before a Subcommittee of the House Committee on Ways and Means on November 5, 2009 regarding the purposes of FATCA. He testified that the overarching goal was to require U.S. taxpayers to report global income in order to reduce illegal and intentional tax avoidance. Once money is transferred outside the U.S., the difficulties escalate for the IRS to validate that taxable income is correctly reported. With reference to offshore income reporting, Chief Counsel Wilkins outlined several areas of concern for the IRS. One particular area of concern was the ability of U.S. taxpayers to intentionally avoid reporting global income on their indirect investments made through foreign entities.[8]

The specific challenge for the IRS was that international financial institutions (intermediaries) lack the formal obligation to report on non-U.S. source income of a U.S. customer. Chief Counsel Wilkins explained the current reporting obligations reveal inadequacies in two respects. He stated,

> First . . . there is generally no obligation to report the non-U.S. source income of a U.S. customer that's not paid within the United States, or to report the gross disposition proceeds of a U.S. customer who does not communicate with the institution from within the United States.
>
> Second, a foreign corporation or other foreign entity is normally not subject to Form 1099 and back-up reporting and withholding rules that apply to U.S. persons, even if that foreign entity is owned by a U.S. taxpayer who does have the obligation to pay tax on the entity's income.[9]

The United States and many other nations have utilized numerous approaches to combat tax evasion and, in particular, offshore tax evasion. Underreporting and underpayment of tax liabilities account for more than 90 percent of the $450 billion tax gap dollars.[10] While the IRS has not estimated the size of the

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[7] U.S. Department of the Treasury Resource Center, Foreign Account Tax Compliance Act states "FATCA was enacted in 2010 by Congress to target non-compliance by U.S. taxpayers using foreign accounts. FATCA requires foreign financial institutions (FFIs) to report to the IRS information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest."

[8] *Foreign Bank Account Reporting and Tax Compliance: Hearing before the Subcomm. on Select Revenue Measures of the Comm. On Ways and Means*, 111th Cong 12-13 (2009) (statement of William J. Wilkins, Chief Counsel, Internal Revenue Service).

[9] *Foreign Bank Account Reporting and Tax Compliance: Hearing before the Subcomm. on Select Revenue Measures of the Comm. On Ways and Means*, 111th Cong 12-13 (2009) (statement of William J. Wilkins, Chief Counsel, Internal Revenue Service), pp. 12–13.

[10] IRS, *Overview Tax Gap for Financial Year 2006.* See www.irs.gov/pub/newsroom/overview_tax_gap_2006.pdf and the U.S. Senate Permanent Subcommittee on Investigations Staff

international tax gap, the Treasury Inspector General for Tax Administration reported in 2012 that estimates range from $40 billion to $123 billion annually.[11]

The critical underlying factual tax justification for FATCA ultimately rests on a single statement and footnote in the first line in the 2008 Report from the Senate Subcommittee on Permanent Investigations:[12]

> Each year, the United States loses an estimated $100 billion in tax revenues due to offshore tax abuses.[13]

This raises a few questions. Is that number true and accurate? If so, then what was the statistical methodology used to make the calculation?

The answers start in 2001. The Congressional Research Service (CRS) provided a Memorandum of July 23, 2001 referencing an inquiry made by the House Majority Leader as to the method used by attorney Jack Blum to construct the estimate of $70 billion of illegal tax evasion losses due to tax havens. This figure was contained in his Affidavit submitted in support of the government's

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Report, *Tax Haven Banks and U.S. Tax Compliance*, July 17, 2008. See www.hsgac.senate.gov/download/report-psi-staff-report-tax-haven-banks-and-us-tax-compliance-july-17-2008. Accessed February 20, 2012.

[11] Testimony of Honorable J. Russell George, Treasury Inspector General for Tax Administration, "Problems at the Internal Revenue Service: Closing the Tax Gap and Preventing Identity Theft", Hearing Before the Committee on Oversight and Government Reform, Subcommittee on Government Organization, Efficiency, And Financial Management, U.S. House Of Representatives, April 19, 2012, p. 12. See www.treasury.gov/tigta/congress/congress_04192012.pdf. Accessed December 31, 2012.

[12] Hearings before Permanent Subcommittee on Investigations Role of U.S. Correspondent Banking in International Money Laundering, March 2, 2001.

[13] Secretary of the Treasury O'Neil highlighted to the never ending computer life of something not true in his testimony before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs United States Senate One Hundred Seventh Congress First Session on July 18, 2001—

> Well, thank you. I was frankly thunderstruck when I got the letter from these distinguished people, because I could not believe that they had read what I said, and I think you will hear today that they were responding to press accounts. As I said before, they did not respond to what I said at all. They responded to misrepresentations in the media, and I am sorry to be so blunt about it, but there is no other way to characterize it. If you look at the pieces that are in this book, if you can find any connection between the representations that were made in these stories and what I have said on the record and off the record, there is no connection whatsoever. But, intelligent people, including these distinguished citizens who have served in their government, took what they read at face value. Many of them know better, because they have been subjected to this, but they had forgotten.
>
> So, when they read it in the newspaper, they filed—you would not believe, I get 2,000 letters a week and many of them are responding to things that I never said, never imagined and never would imagine, but I am still getting letters about it as though it were the real stuff simply because it appears in print. These days, with the wonderful technology we have with Lexis Nexis and all the rest of that, once this stuff is on the record it never goes away. It is always a primary source. So, when I am 95, I am going to be getting letters saying we cannot believe you did not want to prosecute money launderers. I will let them speak for themselves.

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request from the federal court for a John Doe summons for records from MasterCard and American Express.

According to the CRS,

> Mr. Blum's estimate was contained in a declaration filed in connection with a petition the Internal Revenue Service filed with the U.S. District Court for the Southern District. In response to your request, we contacted Mr. Blum and discussed his estimate; he was not able to send us a written discussion of his estimating procedure . . . We did not discuss these particular aspects of the estimating process in our initial conversation with Mr. Blum and our attempts to contact Mr. Blum on a follow-up basis have not been successful.[14]

Mr. Blum has been described as follows: "Mr. Blum is under contract to the IRS, he testifies before Senate committees and has provided an affidavit in support of at least one IRS search warrant."[15]

This same statement of $70 billion was given by Jack Blum in testimony in 2002. When asked about that number he admitted it was imprecise stating, "You just have to take a guess at it."

In July 2008, the Senate Permanent Subcommittee on Investigations chaired a hearing and issued a report entitled "Tax Haven Banks and U.S. Tax Compliance." This report examined how tax haven banks facilitate tax evasion by U.S. clients that cost U.S. taxpayers an estimated $100 billion each year. This Report, widely cited as authority for the claim that $100 billion is lost in taxes because of evasion of tax through tax havens, is, in fact, merely based on footnote 1 of the Report which cites to information unsubstantiated in five magazine articles that varied widely in terms of authors and opinions regarding the amount of tax losses the U.S. incurs.[16] None of the cited articles provide any empirical evidence or known statistical methodology on how the number was calculated. The Report makes no claim that the $100 billion tax loss is based on anything else than these published articles.

IRS Commissioner Charles Shulman, in testifying before the Permanent Subcommittee on Investigations on March 4, 2009, was questioned on the analysis of hidden money criminally held overseas:[17]

> Senator McCaskell: "Has there been any analysis done of how much of this money that is being hidden overseas is, in fact, a result of criminal activity?"

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[14] Congressional Research Service memorandum to House Majority Leader, attention Elizabeth Tobias, *Reported Estimate of U.S. Tax Revenue Lost Through Use of Tax Havens*, July 23, 2001.

[15] Kleinfeld, Denis, IFC Review, "US Scandals Reinforce Warning Signs of FATCA's Dangers" (July 1, 2013). See http://www.ifcreview.com/restricted.aspx?articleId=6390&areaId=39 (accessed November 15, 2014).

[16] Permanent Subcommittee on Investigations, Tax Haven Banks and U.S. Tax Compliance, Hearing on March 4, 2009.

[17] Permanent Subcommittee on Investigations, Tax Haven Banks and U.S. Tax Compliance, Hearing on March 4, 2009.

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> Mr. Shulman: "Not that I am aware of. I mean, estimating how much money that is overseas and not being paid to the government. As far as I am aware, there is no credible estimate because it is kind of a chicken and egg. It is over there and we have not found it, it is hard to estimate what is there. And all estimates that I have seen have not broken down criminal versus civil because, again, until we see the cases, it is hard to say."

In 2010 the Senate and the House of Representatives reached an agreement and voted to enact the $18 billion HIRE Act. FATCA was enacted as part of the HIRE Act to provide revenue offset for the increased spending by the government. The Congressional Joint Committee on Tax estimate that FATCA will generate $8.7 billion over ten years or average revenue $870 million per year is a very far cry from $100 billion annually.

§ 1.03 THE UBS SCANDAL

The UBS scandal was a key driver of the enactment of FATCA. U.S. Senator Carl Levin and the Senate Permanent Subcommittee on Investigations noted over 50,000 U.S. persons with suspicious Swiss UBS bank accounts. "John Doe" summons were issued by the U.S. Justice Department against the UBS bank, requiring information on the U.S. accountholders. The UBS scandal involved accusations of the IRS against the Swiss bank of cooperating with U.S. citizens in concealing their assets held in Switzerland. UBS and the Department of Justice settled with a $780 million fine imposed on UBS and the Department receiving the names of over 4,000 U.S. accountholders.

The UBS scandal created momentum in the U.S. Congress and administration against bank secrecy and offshore tax evasion and supported the passage of the FATCA legislation. The origin of the funds held by the 52,000 accounts originally requested in the UBS case is unknown, but it is probable that there are other financial institutions around the globe located in offshore financial centers and in OECD financial centers, such as Miami, and corporate service providers with little regulation, such as in Delaware, allowing for the same kind of unlawful practices that UBS has admitted to undertaking and facilitating. Other developed countries, like Brazil, Russia, India, and China, are undoubtedly also pondering if the banks in financial centers like Switzerland, London, New York, and Miami, have lured their own citizens with promises of turning a blind eye to foreign tax and exchange control laws.

The IRS reports that since 2009 it has charged more than thirty banking professionals and seventy-one accountholders with violations. In 2013, a former UBS client pled guilty to two criminal counts of filing false tax returns for failing to report her offshore accounts left to her by her deceased husband for seven years (2001–2007). Mary Estelle Curran, uneducated beyond high school, was 79 at the time of the pleading, and owes $667,716 in taxes plus interest and penalties. Her penalty for failure to report the foreign bank accounts is $21,666,929, comprised of 50 percent of the high balance of the accounts. Prosecutors originally requested

up to six years of prison but the Judge sentenced her to only one year of probation.[18]

§ 1.04 OFFSHORE VOLUNTARY DISCLOSURE PROGRAM

The IRS created the 2009 Offshore Voluntary Disclosure Program, a partial amnesty allowing persons not under audit to disclose unreported offshore activities and benefit from a reduction of civil and criminal penalties. The IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives and has collected more than $4 billion.[19] The IRS also began its third offshore voluntary disclosure program (OVDP) in January 2012, on the heels of strong interest in the 2011 and 2009 programs. It is open for an indefinite period until otherwise announced. The 2012 OVDP offers a higher penalty rate than the previous program[20] but offers clear benefits to encourage taxpayers to disclose foreign accounts now rather than risk detection by the IRS and possible criminal prosecution. The Government Accountability Office (GAO) found in early 2013 that despite 39,000 disclosures and $5.5 billion revenue obtained primarily from penalties, the IRS may be missing potential tax penalties from “quiet filers” who amend previous years’ returns to include foreign accounts but avoid paying the penalties by not entering the OVD program.[21]

The Taxpayers Advocate Service has issued its “FY2014 Objectives Report to Congress and Special Report to Congress” which provides an accurate picture of IRS operations. The Taxpayer Advocate Service (TAS) was created as part of the IRS Reform and Restructure Act of 1998. This Act also created the office of the Inspector General for Tax Administration and the IRS Oversight Board. The Internal Revenue Code requires the National Taxpayer Advocate to submit two annual reports to the House Committee on Ways and Means and the Senate Committee on Finance.[22] The National Taxpayer Advocate is required to submit these reports directly to the Committees without any prior review or comment from the Commissioner of Internal Revenue, the Secretary of the Treasury, or the Office of Management and Budget.[23] The first report, due by June 30 of each year,

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[18] Browning, Lynnley, Fortune, “Offshore account holders win a victory in government tax case” (April 29, 2013). Also see Saunders, Laura, “Leniency for Offshore Cheats”, Wall Street Journal (May 5, 2013).

[19] IRS, *IRS Offshore Programs Produce $4.4 Billion to Date for Nation’s Taxpayers; Offshore Voluntary Disclosure Program Reopens*, IR-2012-5, January 9, 2012. See www.irs.gov/newsroom/article/0,,id=252162,00.html. Accessed February 20, 2012.

[20] Under the current OVDP, the offshore penalty has been raised to 27.5 percent from 25 percent in the 2011 program. The reduced penalty categories of 5 percent and 12.5 percent are still available.

[21] GAO-13-318, Offshore Tax Evasion. IRS has collected billions of dollars, but it may be missing continued evasion, March 23, 2013, http://www.gao.gov/assets/660/653369.pdf (accessed November 15, 2013).

[22] IRC § 7803(c)(2)(B).

[23] IRC § 7803(c)(2)(B)(iii).

must identify the objectives of the Office of the Taxpayer Advocate for the fiscal year beginning in that calendar year.[24]

The TAS has pointed out to Congress scandals that have enveloped the IRS. Over the last few months, the Internal Revenue Service has been the center of public attention for several reasons, mostly notably its scrutiny of "conservative leaning" politically active social welfare organizations seeking recognition as tax-exempt entities. The public attention to these recent events has in many ways reinforced many taxpayers' preconceived perceptions of the IRS as an agency that treats taxpayers unfairly. While all this is grievous enough and, in fact, calamitous for public respect for and compliance with the tax laws (because once lost, trust takes a very long time to be regained), these events are symptoms of broader problems festering at the IRS.

The TAS 2014 Report further stated, "The IRS is an institution in crisis. In my view, however, the real crisis is not the one generating headlines. The real crisis facing the IRS—and therefore taxpayers—is a radically transformed mission coupled with inadequate funding to accomplish that mission.[25] As a consequence of this crisis, the IRS gives limited consideration to taxpayer rights or fundamental tax administration principles as it struggles to get its job done."

The IRS offers a series of offshore voluntary disclosure (OVD) programs to settle with taxpayers who had failed to report offshore income and file one or more related information returns (e.g. Form TD F 90-22.1, *Report of Foreign Bank and Financial Accounts (FBAR)*.[26] As described in prior reports, these programs apply a one-size-fits-all approach designed for either "bad actors" or "benign actors" who inadvertently violate the rules, requiring them to opt-in and then opt-out, then subjecting them to lengthy examinations and draconian civil and criminal

[24] IRC § 7803(c)(2)(B)(i).

[25] National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*).

[26] The Bank Secrecy Act (BSA) requires U.S. citizens and residents to file an FBAR so the government can better detect those engaged in tax evasion, terrorism and money laundering. See generally 31 USC § 5321(a)(5); 31 CFR §1010.350; Internal Revenue Manual (IRM) 4.26.16 (July 1, 2008); Joint Committee on Taxation (JCT), JCS-5-05, General Explanation of Tax Legislation Enacted in the 108th Cong. 377–78 (May 2005). The terms of these programs are all promulgated by frequently asked questions (FAQs) posted to various IRS websites, rather than published in the Internal Revenue Bulletin, as the IRS had done with earlier programs. See *IRS, Voluntary Disclosure: Questions and Answers*, http://www.irs.gov/uac/voluntary-disclosure:-questions-and-answers (first posted May 6, 2009); IRS, 2011 *Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers*, http://www.irs.gov/businesses/international-businesses/2011-offshore-voluntary-disclosure-initiative-frequently-asked-questions-and-answers first posted Feb. 8, 2011); IRS, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers, http://www.irs.gov/individuals/internationa-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers first posted June 26, 2012.

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penalties.[27]

The Government Accountability Office (GAO) analysis shows that the offshore penalties paid by taxpayers with the smallest accounts (i.e., those in the tenth percentile with accounts of $78,315 or lower) were disproportionate—at least 575 percent of the tax, interest, and penalties on their unreported income.[28] The offshore penalties were also disproportionately greater than the amount paid by those with the largest accounts (i.e. those in the ninetieth percentile with accounts of more than $4 million) who paid 86 percent or less.[29] Moreover, the IRS initially processed applications from benign actors who are expected to opt-out much more slowly than bad actors.

The National Taxpayer Advocate remains concerned that the IRS does not have a simple and easy method for allowing benign actors who are U.S. residents to resolve post filing delinquencies. Nor has the IRS provided clear guidance about key terms that it has used in its programs, such as whether someone will be considered "high risk," how they may avoid a penalty. (e.g. by demonstrating "reasonable cause"), and when they will be subject to the lower penalty applicable to "non-willful" conduct. The uncertainty surrounding these terms and the consequences of opting out has likely prompted some benign actors to pay more than they should inside the OVD program.

In further rebuking the IRS, the TAS 2014 Report states, in addition, the IRS has reportedly revoked pre-clearance letters authorizing taxpayers to participate in the OVDP, even though some had already made disclosures, filed returns, and paid taxes and penalties in reliance on the IRS's letters. These reversals further erode the IRS's creditability, and are more likely to reduce than increase voluntary compliance.[30] Moreover, the IRS has not adopted the National Taxpayer Advocate's recommendation to send notices to educate those with foreign accounts

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[27] In addition to criminal penalties, the maximum civil penalty for "willfully" failing to report foreign accounts on an FBAR is severe—the greater of 50 percent of the account or $100,000 per year. 31 USC §5321(a)(5)(C). Specific problems with these settlement programs are described in prior reports. See e.g. National Taxpayer Advocate 2012 Annual Report to Congress 134–153; National Taxpayer Advocate 2011 Annual Report to Congress 191–205 and 206–72; National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 7–8 and 21–29. See also Taxpayer Advocate Directive 2011-1 (Aug. 16, 2011).

[28] See GAO, GAO-13-318, *IRS Has Collected Billions of Dollars, but May be Missing Continued Evasion* 13 (Mar. 2013) (TAS analysis of data reflected on Table 2).

[29] *Id*. The total tax, interest, and penalties row in the GAO table may include tax, interest, and penalty amounts that are not part of the OVD program assessments. Taxpayers who are in the 10th percentile for offshore account balances are not necessarily the same individuals who are in the 10th percentile for total tax, penalties, and interest. Nor are taxpayers who are in the 90th percentile for offshore account balances necessarily the same individuals who are in the 90th percentile for total tax, interest, and penalties.

[30] Letter from Chair, The Personal Income Taxation Committee, New York City Bar to Acting Commissioner, IRS, (May 8, 2013), reprinted as, *NYC Bar Committee Urges IRS to Restore Integrity to Offshore Voluntary Disclosure Program*, 2013 TNT 98-18 (May 21, 2013).

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about the requirements. Nor has the IRS addressed the unnecessarily burdensome requirement to report certain accounts on both Form 8938 and the FBAR.

Finally, in FY2012 and FY2013 YTD, TAS assisted 474 taxpayers with OVD related problems and issued four taxpayer assistance orders (TAOs). In the three cases in which the IRS did not comply with the TAOs, the National Taxpayer Advocate elevated (or plans to elevate) them to the Operating Division commissioner level or above.[31]

§ 1.05 FATCA AND FOREIGN COUNTRIES

FATCA has created some considerable concerns from the foreign institutions to which it is meant to apply. Foreign banks and governments had mounted a push against the imposition of FATCA since its first proposal. The Banks have paid significant costs already. On CNBC an internet article stated that, ". . . the task of scouring records for U.S. citizens and then reporting them could run into billions of dollars." Terry Campbell, head of the Canadian Bankers Association, was quoted as saying the act was, "conscripting financial institutions around the world to be arms of the U.S. tax authorities." The article goes on to point out that, "Officials are skeptical that the burden of FATCA will outweigh the benefit of access to the U.S. and have stressed the even indirect contact with the U.S. markets will incur the withholding tax."[32]

A partner, in one of the largest accounting firms, made an observation (which is turning out to be accurate):

> Banks, investment funds, insurance companies, wealth managers, trusts, partnerships, private equity and other vehicles will be FFIs and required to apply FATCA. What makes the regime so burdensome is that it requires specific documentations for virtually all account holders of an FFI. Some retail banks in Europe have millions of accounts; therefore it is not difficult to imagine that investigating all these accounts is a huge task.[33]

The costs could be staggering. The Banking Federation and the Institute of International Bankers, in what they call conservative figures, estimate that it will cost each foreign bank with more than 25 million accounts $250 million to sift through those accounts and identify those held by Americans. Costs to the top thirty foreign banks alone would be $7.5 billion.[34] The recent cost estimate of the U.K. Revenue for U.K. financial institutions is a one-off cost, even considering the

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[31] For a discussion about the IRS's confusion regarding the National Taxpayer Advocate's authority in this area, see National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 7–9 and 26–27.

[32] Banks Battle Over U.S. Tax Laws, *Financial Times*, June 12, 2011.

[33] Banks Battle Over U.S. Tax Laws, comment by KPMG, *Financial Times*, June 12, 2011.

[34] European Banking Federation and Institute of International Bankers, comments on Notice 2010-60, November 12, 2010.

IGA, of approximately £900 million–£1,600 million, with an ongoing cost of £50 million–£90 million a year.[35]

How can foreign and potentially U.S. FATCA-covered financial institutions calculate the cost exposure? Although it has been reported FATCA is creating a gold rush for "a smorgasbord of consultants and software providers," the difficulty in determining fees is dependent on variables not yet fully realized—unproven technology,, shifting political climates affecting government policy direction, a country's economic health, trade balancing, the need to have access to the U.S. investment markets, and a whole host of other factors.

It is widely understood compliance with FATCA by foreign financial institutions will result in an immense amount of searchable data and information, or access thereto, on virtually everyone that has a financial account reported under FATCA to a foreign financial institution according to the FFI's FATCA compliance protocol.

The tax haven jurisdictions are viewed as a major cause of international tax evasion because of the claimed lack of information made available and horrors of secrecy. A number of facts pointed out in 2001 by the Organization of Commonwealth Caribbean Bar Associations show this view as likely a fallacy:

1) The U.S., one of the 30 member countries of the OECD, has already signed Tax Information Exchange Agreements (TIEAs) with 20 non-OECD countries and territories and it is currently seeking TIEAs with several other Caribbean countries and territories.[36]

2) The U.S. increased its statutory withholding tax on savings income such as dividends, interest, and royalties from 12.5 percent to 30 percent over 60 years ago, in 1942, as a "temporary wartime measure."[37]

3) The U.S. never reduced its statutory withholding tax rate after the end of World War II because the U.S. Treasury found that its high statutory withholding tax on savings income encouraged other countries to enter into income tax treaties with the U.S.[38]

4) The U.S. had income tax treaties in force with 15 Caribbean countries (Anguilla, Antigua and Barbuda, Aruba, Barbados, Belize, the British Virgin Islands, Dominica, Grenada, Jamaica, Montserrat, the Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Trinidad

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[35] HMRC, Tax information and Impact Note—The International Tax Compliance (United States of America) Regulations 2013, August 7, 2013, http://www.hmrc.gov.uk/fatca/itc-regs-2013.pdf (accessed November 30, 2013).

[36] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[37] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[38] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

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and Tobago) until the U.S. unilaterally canceled most of these treaties during the 1980s.[39]

5) The income tax treaties between the U.S. and these Caribbean countries provided for the exchange of tax information and also provided tax benefits that included reduced withholding taxes on U.S. savings income derived by residents of these Caribbean countries.[40]

6) The U.S. currently has income tax treaties in force with more than 60 countries, virtually all of which provide for substantial reductions in the withholding tax on U.S. savings income derived by residents of the other treaty country, generally to rates of 15 percent or less, but the only Caribbean countries with which the U.S. now has income tax treaties are Barbados, Jamaica, and Trinidad and Tobago.[41]

7) The U.S. Caribbean Basin Initiative (CBI) legislation, originally enacted in 1983 and subsequently amended, authorizes the U.S. Treasury to give limited tax benefits to qualified Caribbean countries that enter into TIEAs with the U.S., and the U.S. Treasury has signed several TIEAs with Caribbean countries that provide up to three such benefits: convention expense deductions for Americans attending business conventions, domiciles for foreign sales corporations, and investment funds from Puerto Rico under a twin-plant program.[42]

8) The convention expense deduction is of limited value to some of the smaller Caribbean countries, and the other two benefits are no longer operative for any country as a result of action by the WTO and the U.S. Congress.[43]

9) Although most U.S. TIEAs provide for the reciprocal exchange of tax information by both the U.S. and the Caribbean country, the right to obtain such information is generally of considerable value to the U.S. and of little or no value to the Caribbean country.[44]

Also overlooked is the fact the U.S. "maintains enormous offshore havens in

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[39] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[40] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[41] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[42] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[43] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

[44] Resolution on Tax Information Exchange Agreements (TIEAs) adopted by the OCCBA Conference on September 7, 2002.

Florida, Delaware and other U.S. states."[45] It is interesting to realize FATCA is being considered by mostly OECD countries, none of which are considered to be tax havens or considered as engaging in harmful tax competition. There are a significant number of countries—particularly those countries considered to be touched by international terrorism and money laundering—that are seemingly ignored by the FATCA movement.

§ 1.06 THE U.S. TAX SYSTEM AND ITS COMPLEXITY

The current U.S. income tax law is 100 years old. The 16th Amendment to the U.S. Constitution was ratified by the Congress on February 3, 1913. Known as the United States Revenue Act of 1913, it was signed into law October 3, 1913. The argument for the need for an income tax then, as it is now, is that the rich were not paying their fair share of tax. During the 100 years of having experienced the benefits and detriments of an income tax system, it should be possible to make some factual observations in light of the fact that it is just this very tax regime, income tax, which is the basis for FATCA reporting.

The current U.S. President laid out this vision of the "1 percent" versus the "99 percent" when proposing his first and only budget in 2009. That budget did not receive a single vote by either party in the House or the Senate. The tax policy of this President is to raise taxes on the "rich."

A recent article points out that the massive fiscal crisis that the federal government is now experiencing is due to the manner in which the federal income tax historically distributes its costs and benefits. The author observes [t]he U.S. federal income tax is in crisis, a crisis that has recently reached new depths, as the fiscal stalemate in the nation's capital dramatically attests."[46] The federal tax base is under widespread assault, and successful federal tax reform has been eluding Congresses and members of Congress for decades. Across the political spectrum, from President John F. Kennedy's administration through the present day, presidents and legislators have been emphatically calling for massive overhauls of the federal tax code. However, in almost every case, even plans with widespread bipartisan support have failed to produce genuine reform. As tax reform efforts have repeatedly stalled, the income tax base has continued to shrink, giving rise to more and more pressing revenue crises.

The American Institute of Certified Public Accountants (AICPA) has stated these 10 basic principles of good tax policy:

1) Equity and Fairness. Similarly—situated taxpayers should be

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[45] As observed in Weglin & Co., Farewell America, Investment Commentary No. 365, August 24, 2009. See also Brunson, Samuel D., U.S. as Tax Haven? Aiding Developing Countries By Revoking the Revenue Code, The Columbia Journal of Tax Law (Forthcoming), November 7, 2013 stating, "But the intersection of a number of U.S. tax rules, it turns out, makes the United States an attractive place for foreigners to invest—and hide—heir money."

[46] *Taxing with a Purpose*, Susannah Camic Talk, University of Wisconsin Legal Studies Research Paper No. 1231, August 16, 2013.

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taxed similarly.

2) Certainty. The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.

3) Convenience of Payment. A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.

4) Economy in Collection. The costs to collect a tax should be kept to a minimum for both the government and the taxpayers.

5) Simplicity. The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.

6) Neutrality. The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.

7) Economic Growth and Efficiency. The tax system should not impede or reduce the productive capacity of the economy.

8) Transparency and Visibility. Taxpayers should know that a tax exists and how and when it is imposed upon them and others.

9) Minimum Tax Gap. A tax should be structured to minimize noncompliance.

10) Appropriate Government Revenues. The tax system should enable the government to determine how much tax revenue will likely be collected and when.

The current U.S. tax law meets virtually none of these criteria.

This AICPA list is vastly different than the principles put forward by the OECD, IMF, UN, G-20, and other organizations which favor extending and enforcing the current complex tax system on the rest of the world.

While tax simplification and/or tax reform has been promoted by nearly annual tax reform acts, the result is just more tax code and all the complexity that comes with it. The fact that FATCA is obviously complex is consistent with the current U.S. Internal Revenue Code. In fact complexity of the tax code is the most serious problem faced by taxpayers. Nina Olsen, the Taxpayer Advocate of the Taxpayer Advocate Service (a part of the IRS) presented her 2012 Annual Report to Congress wherein that Report stated:

> An analysis of IRS data by the Office of the Taxpayer Advocate shows it takes U.S. taxpayers (both individuals and businesses) more than 6.1 billion hours to complete filings required by a tax code that contains almost four million words and that, on an average has more than one new provision added to it daily. Indeed, few taxpayers complete their returns without assistance. Nearly 60 percent of taxpayers hire paid preparers and another 30 percent rely on commercial software to prepare their returns. To inspire confidence and trust,

> the tax laws should be comprehensible and the computations of tax should be transparent and relatively simple, yet few taxpayers today can confidently say they understand the tax code or event that they have correctly computed their tax liabilities. In this report, we identify tax complexity as the #1 most serious problem facing taxpayers, and we recommend (as we have in prior reports) that Congress vastly simplify the tax code to make tax compliance easier.[47]

Ms. Olson also made a strong case for tax reform in her Report by requesting the Congress consider the following among other suggestions she made. As to the complexity of the Internal Revenue Code, The TAS 2012 Report states, "The most serious problem facing taxpayers—and the IRS—is the complexity of Internal Revenue Code."[48] However, this must be understood in the light of the fact the Congress has underfunded the IRS, overburdens it with new provisions, and, for the job Congress expects the IRS to perform, IRS is decidedly undermanned.[49]

A 2014 TAS Objective Report is notable in that the TA states that "Today the IRS is an institution in crisis. In my view, however, the real crisis in not the one generating the crisis. The real crisis facing the IRS—and therefore taxpayers—is a radically transformed mission coupled with inadequate funding to accomplish that mission. As a consequence of this crisis, the IRS gives limited consideration to taxpayers' rights or fundamental tax administration principles as it struggles to get its job done."[50]

§ 1.07 IRS TECHNOLOGY PROGRAM

The adequacy of the IRS computer system is subject to audit by the General Accountability Office (GAO).

GAO, in its 2012 assessment of the IRS Technology Program, stated there are internal control issues with the IRS:

> The material weakness in internal control over unpaid tax assessments was primarily caused by financial system limitations and data entry errors that necessitated the use of a compensating statistical estimation process rather than the summation of individual account balance to determine the amount of taxes receivable, the most material asset on [the] IRS's balance sheet.

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[47] National Taxpayer Advocate 2012 Annual Report to Congress, p. vii.

[48] TAS 2012 Annual Report to Congress, p. 2.

[49] TAS 2012 Annual Report to Congress, p. 5 states "The significant and chronic underfunding of the IRS poses one of the most significant long-term risks to tax administration today. Because of funding shortages, the IRS is unable to answer millions of taxpayer telephone calls or timely process letters; the tax gap (i.e. the amount of tax due but uncollected) stands at nearly $400 billion each year; taxpayers believe the tax laws are not being fairly enforced against others; and the federal deficit is unnecessarily large. Some taxpayer problems identified in this report result from poor planning or execution, and it is important that the IRS not use lack of funding as a justification for failing to address these problems. However, the lack of sufficient funding is the sole or significant cause of many taxpayer problems."

[50] See GAO 2014 Objective Report to Congress and Special Report to Congress, p. v.

Serious control deficiencies over unpaid tax assessments are likely to continue to exist until the IRS (1) significantly enhances or replaces the software applications it uses to maintain the subsidiary taxpayer information necessary to support its unpaid tax assessment amounts, and (2) remedies the deficiencies that continue to result in significant errors in taxpayer accounts.

The GAO goes on to state:

> In addition to its internal control deficiencies, [the] IRS faces significant ongoing financial management challenges arising from its continued need to safeguard the large volume of sensitive hard copy taxpayer receipts and related information and to address its exposure to significant improper refunds based on identity theft. Sustained management efforts will be necessary to maintain and build on the progress made to date and to fully address [the] IRS's remaining internal controls and systems deficiencies as well as its financial management challenges.[51]

The GAO 2013 Report is in chart form using the 11 categories specified under FISMA, using yes or no responses with a side box with commentary which is both brief and terse.[52] Matters of policy and documentation appear to receive mostly yes while matters involving implementation or execution appear to receive no. The IRS's ability to fully comply with FISMA is critical in its achieving an ability to implement and administer FATCA. Although the 2013 Report states that there is general compliance by the IRS in nine of 11 security programs, six were fully compliant, three were generally compliant with some problems, and two were not compliant. The GAO 2013 Report does not include recommendations (as it has in previous years) but only reports on the performance achieved by the IRS in using the FISMA guidelines issued by the DHS.

The Treasury Inspector General for Tax Administration (TIGTA) completed its *Annual Assessment of the Internal Revenue Service Information Technology Program* on September 28, 2012 (as of November 15, the 2013 assessment has not been published). TIGTA recognized that the IRS will have responsibility for the tax system but also for the Patient Protection and Affordable Care Act (PPACA). As a result of PPACA, the IRS has been assigned the job of overseeing all U.S. persons' healthcare records in the new healthcare system.

What the TIGTA found was that the IRS has made progress in improving its security and personnel safety but it still needs to continue to ". . . place emphasis on information and physical programs in order to assure that policies, procedures, and practices adequately address security weaknesses."[53]

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[51] GAO-13-120, IRS's Fiscal Years 2012 and 2011 Financial Statements, November 9, 2012. See http://www.gao.gov/assets/650/649881.pdf (accessed November 15, 2013).

[52] See GAO 2013 Annual Report to Congress.

[53] Treasury Inspector General for Tax Administration, "Annual Assessment of the Internal Revenue Service Information Technology System", Reference Number 2012-20-120, September 28, 2012.

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What were the weaknesses? The TIGTA states:

> Weaknesses were identified over system access controls, configuration management, audit trails, physical security, remediation of security weakness, and oversight and coordination on security-related issues. Until the IRS addresses security weaknesses, it will continue to put the confidentiality, integrity, and availability of financial and taxpayer information and employee safety at risk.[54]

The 2013 GAO Report is reflective of the fact that both the TIGTA and IRS have been in the cross hairs of the Ways and Means Committee of the U.S. House of Representatives and the new reporting metrics required by the Department of Homeland Security in its DHS FY 2013 Inspector General Federal Information Security Management Act (FISMA) Reporting Metrics.[55]

§ 1.08 RESPONSIBILITY FOR THE CREATION OF INTERNATIONAL TAX POLICY

International tax policy is nothing new. Ever since two trading countries enacted their respective income tax regimes, there arose a need to deal with cross-border tax issues and important questions on the potential for double taxation. Various government, quasi-government, and non-government forums came into being which directly or indirectly dealt with international tax issues. Currently, there are a vast number of organizations, associations, institutes, and groups that are focused on tax issues in the global arena.

Coordination of international tax policy by non-government bodies is performed by members who are the governments themselves or are private organizations that have a particular ideology they are promoting. In any event, all this occurs without the taxpayers of any country being involved or even aware that their fate is being sealed by a small group of like-minded individuals with an agenda of one kind or another.

Typical of how this works in practice is a report titled *Supporting the Development of More Effective Tax Systems* produced for the G-20 Development Group by the IMF, OECD, UN, and World Bank. The report notes that, "These organizations have worked with regional organizations, such as the African Tax Administration Forum and Inter-American Center of Tax Administrations . . . ."[56] Staffs from the four organizations making the report were also helped by wide consultation with other organizations working in the tax area

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[54] Treasury Inspector General for Tax Administration, "Annual Assessment of the Internal Revenue Service Information Technology System", Reference Number 2012-20-120, September 28, 2012.

[55] Title III of the E-Government Act of 2002, Pub L No 107-374 M-10-28, 116 Stat 2899. In OMB Memorandum, Clarifying Cybersecurity Responsibilities and Activities of the Office of the President and Department of Homeland Security, OMB delegated FISMA compliance to various federal agencies including the IRS.

[56] Supporting the Development of More Effective Tax Systems (2011), p. 2.

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organized by the IMF and their participation in the Task Force on Tax and Development.[57]

The report states "Strengthening domestic resource mobilization is not just a question of raising revenues [a point made above by the AICPA]. It is also about designing a tax system that promotes inclusiveness, encourages good governance, matches society's views on appropriate income and wealth inequalities and promotes social justice."[58] These are theoretical and lofty goals which are not defined nor quantified.

These goals presuppose that each country will impose an income tax regime. These reports do not reference either the complexity of the U.S. IRC, the economic position the United States now finds itself in, nor other OECD countries' income tax regimes and their current economic positions. There is a disconnect between the aspirations of such objectives as "social justice" and the reality, as the taxpayer experiences them, of government tax and other economic policies.

As noted by the international accounting firm Ernst & Young,[59] the OECD's February report titled "Addressing Base Erosion and Profit Shifting" said, "The international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment."

Broadly speaking, the OECD work will cover three key areas: transfer pricing, jurisdiction to tax and measures for countering base erosion. The establishment of separate working groups in each of these areas with country delegates chairing for each—the United Kingdom for transfer pricing, France and the United States for jurisdiction to tax, and Germany for measures for countering base erosion—underscores the keen interest of the OECD member countries in the Base Erosion and Profit Sharing project and its outcomes.

As part of this project, the OECD has also called on the Forum on Tax Administration, which brings together the heads of the revenue authorities of OECD member countries and nonmember countries, to continue its focus on improving tax compliance. The Forum on Tax Administration, composed of the heads of tax administration from 45 countries and part of the OECD, issued the following statement in response to the OECD Report on Base Erosion:

> We welcome the OECD's work on Base Erosion and Profit Shifting (BEPS) that will shortly propose a comprehensive action plan intended to modernize international tax instruments and standards to respond effectively to, and counter, BEPS, notably in the areas of international taxation, transfer pricing and the digital economy, in an effective and appropriate manner. We stand ready to ensure that any new instruments and standards are applied to

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[57] Supporting the Development of More Effective Tax Systems (2011), p. 2.

[58] Supporting the Development of More Effective Tax Systems (2011), p. 8.

[59] See http://www.ey.com/GL/en/services/tax/global-tax-policy-2013.

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> maximum effect to eliminate double non-taxation. We will draw on the work of the OECD in the area of aggressive tax planning and its directory of schemes to improve compliance.[60]

However, international organizations do not direct U.S. tax policy. U.S. tax policy resides with the House Ways and Means Committee and Senate Finance Committee. The Chairpersons of these committees have enormous power in deciding who will be taxed, and who will get tax benefits either in some form of subsidy or, in effect, cash payments. The political process in the U.S. has been described as the chase for money.[61]

§ 1.09 FOREIGN BANK AND FINANCIAL ACCOUNTS REPORT (FBAR)

The Foreign Bank and Financial Accounts Report (FBAR) is utilized to fight tax evasion. The FBAR requirement is not part of the IRC but an element of the U.S. anti-money laundering regime enacted by Congress in 1970, i.e., the so-called Bank Secrecy Act (BSA). The BSA consists of record-keeping and reporting requirements on financial institutions to assist federal agencies in criminal, tax, or regulatory proceedings.[62]

The foreign reporting requirements of the BSA were implemented by regulation and came to be formally known as the Report of Foreign Bank and Financial Accounts and colloquially as FBAR. FBAR is physically embodied as form TD F 90-22.1. In 2003, in an effort to raise the FBAR compliance rate,[63] the Financial

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[60] See Forum on Tax Administration, Final Communique, 16-17 May 2013, Moscow, Russian Federation.

[61] Former Senator and now Secretary of State John Kerry's farewell speech to the Senate on his leaving the Senate after serving for 29 years, January 30, 2013, p. 6. "There is another challenge we must address—and it is the corrupting force of the vast sums of money necessary to run for office. The unending chase for money, I believe, threatens to steal our democracy itself. I've used the word corrupting—and I mean by it not the corruption of individuals, but a corruption of a system itself that all of us are forced to participate in against our will. The alliance of money and the interests it represents, the access it affords those who have it at the expense of those who don't, the agenda it changes or sets by virtue of its power, is steadily silencing the voice of the vast majority of Americans who have a much harder time competing, or who can't compete at all. The insidious intention of that money is to set the agenda, change the agenda, block the agenda, and define the agenda of Washington. How else could we possibly have a U.S. tax code of some 76,000 pages? Ask yourself, how many Americans have their own page, their own tax break, their own special deal?"

[62] Pasley, Robert S., "Recent Developments in Bank Secrecy Act Enforcement", 9 *North Carolina Banking Institute Journal*, p. 61 (2005). The current statement of purpose is set out in 31 USC § 5311 which states:

> It is the purpose of this subchapter (except section 5315) to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.

[63] US Treasury Department, Report to Congress in Accordance with Act Sec. 361(b) of PL 107-56 of the USA PATRIOT Act, April 26, 2002 ("Treasury Report"), p. 6.

Crimes Enforcement Network (FinCEN) delegated its enforcement authority for the FBAR to the IRS by means of a Memorandum of Agreement between FinCEN and the IRS.[64] The legislative authority for the imposition of FBAR is now found in 31 USC Section 5314.[65]

U.S. citizens, residents, partnerships, corporations, limited liability companies, trusts, and estates that have either a financial interest in or signature authority over foreign financial accounts with an aggregate value exceeding $10,000 at any time during the calendar year must file a FBAR. Financial accounts subject to FBAR reporting include banks, credit cards, securities, retirement plans, mutual funds, and life insurance.[66] A foreign financial account may be reported on multiple FBARs.[67] FBAR reporting is required even if the foreign account does not generate taxable income.

Failure to comply with FBAR reporting, where required, will subject the offending person to criminal and or civil sanctions. Even a non-willful failure to file a FBAR can carry a civil penalty of $10,000 per violation.[68] A willful violation can constitute tax fraud with a penalty of the greater of $100,000 or 50 percent of the balance in the account. The penalty can be assessed on an annual basis, which when aggregated can surpass the amount in the account.[69] On the criminal side, a willful failure to report can be treated as a felony for evasion of tax which is punishable by a fine up to $250,000 or five years imprisonment, or both.[70] In limited instances, where reasonable cause is shown for the failure to file the FBAR, penalties may be waived.[71]

The IRS published a new Internal Revenue Manual provision, effective November 11, 2013, dealing with various matters for FBAR cases in Appeals. These matters include the following:

- New FinCen Forms 114 and 114(a) have replaced form TDF 90-22.1 (Report of Foreign Bank and Financial Accounts) which is now obsolete.

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[64] 68 FR 26,468, May 16, 2003, codified at 31 CFR § 103.56(g).

[65] 21 USC title 31, "Money and Finance"; subtitle IV, "Money"; chapter 53, "Monetary Transactions"; subchapter II, "Records and Reports on Monetary Instruments Transactions"; section 5314, "Records and Reports on Foreign Financial Agency Transactions."

[66] There are certain exceptions to the FBAR reporting requirements. For example, U.S. military banking facilities that operate through U.S. financial institutions to serve U.S. military personnel in a foreign jurisdiction are not treated as foreign bank accounts nor are they subject to FBAR reporting requirements.

[67] For example, where a foreign account is owned by a U.S. corporation, both the corporation and its individual officers who have signature authority over the account are required to file a Report of Foreign Bank and Financial Accounts (FBAR) form.

[68] 31 USC § 5321(a)(5)(A).

[69] 31 USC § 5321(a)(5)(C).

[70] 31 USC § 5322.

[71] 31 USC § 5321(a)(5)(B)(ii).

FinCen Report 114 is for electronic filers and FinCen Report 114(a) is for filers who submit FBAR with spouses, or desire to file through third-party preparers. Effective July 1, 2013 the FBAR must be filed electronically through the Bank Secrecy Act E-File system.

- Appeals have authority to resolve penalties only under $100,000.
- There is limited availability of Alternative Dispute Resolution (ADR) Rights.
- Litigation regarding FBAR penalties will be in a U.S. District Court rather than tax court.

There are other matters as well, more fully discussed in Chapter 5.

FBAR has been inadequate in reducing tax evasion.[72] See Chapter 5 for a detailed explanation of the FBAR compliance requirements.

§ 1.10 QUALIFIED INTERMEDIARY PROGRAM (QI)

The U.S. commitment to tackle offshore tax evasion was accelerated with the initiation of the Qualified Intermediary Program (QI) on January 1, 2001. The IRS established the regulations in order to ensure tax collection on U.S. investment income benefitting U.S. persons and to force foreign financial institutions to disclose to the IRS those U.S. taxpayers that are beneficial owners of foreign accounts. Under the QI regulations, U.S. paying agents must collect backup withholding tax of 28 percent on payments from investments in the U.S. paid to non-U.S. financial intermediaries that have not entered into a QI agreement with the IRS.[73] Thus, in order to avoid a blanket withholding on all U.S. investment income, a foreign institution must enter into a QI agreement, becoming a "Participating QI".

A Participating QI agrees to certain documentation and withholding responsibilities in exchange for:

(i) simplified information reporting for its foreign account holders,

(ii) the ability not to disclose proprietary account holder information to a withholding agent that may be a competitor, and

(iii) the ability to escape the application of backup withholding upon payments to it.

The QI agreement requires a Foreign Financial Intermediary (FFI) to disclose information about accounts of U.S. taxpayers to the IRS.

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[72] Dean Marsan, "FATCA: The Global Financial System Must Now Implement a New U.S. Reporting and Withholding System for Foreign Account Tax Compliance, Which Will Create Significant New Exposures—Managing This Risk," *Taxes—The Tax Magazine*, July 2010, pp. 63–64.

[73] The backup withholding will be applied even though the U.S. does not impose withholding tax on certain forms of interest payments, such as from bank deposits and from portfolio interest.

The QI agreement provides for audits of the Participating QI by IRS approved auditors, such as an accounting firm, to ensure compliance with the agreement. However, U.S. owners can hide their identities through foreign corporations. The FFI is only required to report the corporation, not the owner, and is permitted to accept documentation at face value unless the FFI has a reason to know that the documentation is invalid. Participating financial institutions that do not fulfill their QI obligations risk being (1) denied access to correspondent banks in the U.S., and (2) severed from U.S. financial transactions.

See Chapter 11 for a detailed explanation of the QI regime and its overlap with FATCA.

§ 1.11 THE OECD TAX INFORMATION EXCHANGE INITIATIVE[74]

[1] Exchange of Information Upon Request

Several multinational initiatives over the past years focused on tax evasion.[75] The Organization for Economic Cooperation and Development (OECD) has led the international effort. In 1996 the OECD, comprised of 30 countries, formed a working group called the Forum on Harmful Tax Competition to fight tax practices that are harmful to international compliance.[76] A 1998 OECD report criticized tax havens that refused to cooperate with its international tax initiative, followed by a 2000 OECD report criticizing bank secrecy laws in tax havens. These reports set the stage for the 2004 incorporation of the standard that all OECD countries should "permit tax authorities to have access to bank information, directly or indirectly, for all tax purposes so that tax authorities can fully discharge their revenue raising responsibilities and engage in effective exchange of information."[77]

In 2000, the OECD began obtaining written commitments from offshore jurisdictions to enter into TIEAs in an effort for those jurisdictions not to be identified as uncooperative tax havens. A tax haven was defined by the OECD as "as a country with no or nominal taxation, ineffective tax information exchange with other countries, and a lack of transparency in its tax or regulatory regime, including excessive bank or beneficial ownership secrecy."[78] The OECD published a list of 35 offshore jurisdictions that it planned to later list as uncooperative tax havens unless the individual countries made written commitments to exchange

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[74] The OECD's exchange of tax information page can be found at http://www.oecd.org/tax/exchange-of-tax-information/ (accessed November 15, 2013).

[75] OECD Subcommittee, *supra*.

[76] OECD Subcommittee, *supra*.

[77] OECD Subcommittee, *supra*, citing "Improving Access to Bank Information for Tax Purposes," issued by the OECD (2000), p. 20. In 2004, this standard was incorporated into paragraph 5 of Article 26 of the OECD Model Tax Convention on Income and Capital.

[78] OECD Subcommittee, *supra*, citing "Improving Access to Bank Information for Tax Purposes," issued by the OECD (2000), p. 27.

international criminal and civil tax information at later dates.[79]

In 2000, the OECD established the Global Forum on Taxation for OECD member countries and non-member countries to discuss information exchange. In 2002, the OECD created a model tax information exchange agreement (TIEA).[80] TIEAs are more limited than treaties as they only allow for tax information exchange. TIEAs require the tax authorities of two countries to agree to exchange information involving both civil and criminal tax issues. The parties agree to share information regardless of whether the person is a citizen of either nation or whether the parties are violating tax or bank secrecy laws. OECD Member States and other jurisdictions committed themselves, on the occasion of the publishing of this model agreement, to establish a permanent dialogue addressed to implement tax information exchange.

In 2004, as previously mentioned, the OECD modified Article 26 of the Model Convention, introducing a new paragraph 4 (scope of the obligation of exchanging information) and paragraph 5 (regarding bank secrecy, which cannot be used to refuse such exchange of information). The exchange of information upon request became the internationally agreed upon standard and the G20 Finance Ministers expressed support for the OECD's tax information exchange efforts in November of 2004:

> We are therefore committed to the high standards of transparency and exchange of information for tax purposes that have been reflected in the Model Agreement on Exchange of Information on Tax Matters as released by the OECD in April 2002. We call on all countries to adopt these standards.

The UN Committee of Experts on International Cooperation in Tax Matters also endorsed this standard and consequently modified Article 26 of its Model Convention and its respective comments.

In 2007, the OECD stated that three countries, Austria, Luxembourg, and Switzerland, had "significant restrictions on access to bank [information] for tax purposes." It also cited a number of financial centers that restricted the exchange of information (Cyprus, Liechtenstein, Panama, and Singapore) as well as offshore financial centers that committed to implement standards on transparency of information but failed to do so.[81] But as of 2012, the OECD had commitments from all major international centers to eliminate bank secrecy for tax purposes.[82] Switzerland, Singapore, Austria and Liechtenstein have already implemented commitments.[83] Currently, 121 jurisdictions[84] have agreed, within the framework

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[79] OECD Subcommittee, *supra*, citing "Improving Access to Bank Information for Tax Purposes," issued by the OECD (2000), p. 27.

[80] See www.oecd.org/ctp/exchangeofinformation/2082215.pdf. Accessed December 31, 2012.

[81] See www.oecd.org/ctp/exchangeofinformation/2082215.pdf. Accessed December 31, 2012.

[82] Guest Author, "Are tax havens disappearing?" *OECD Insights*, March 12, 2012. www.oecdinsights.org/2012/03/12/are-tax-havens-disappearing-yes-but-this-is-only-the-beginning.

[83] Guest Author, "Are tax havens disappearing?" *OECD Insights*, March 12, 2012.

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of the Global Forum, to comply with the standard of fiscal transparency.

There are more than 3,000 bilateral treaties based on Article 26.[85] The information exchange process as provided for in income tax treaties and TIEAs is an information exchange on request, drafted to disallow random and imprecise requests of information, known as "fishing expeditions". The threshold of specificity required by OECD model convention is high. The requesting country has to provide the following information to the requested country:

(i) the name of the taxpayer;

(ii) a statement of the information sought, including its nature;

(iii) the tax purpose for which the information is sought;

(iv) the reasons for believing that the information sought is held by the requested party, or is in the possession or control of a person within the jurisdiction of the requested party;

(v) to the extent known, the name and address of any person believed to be in possession of the requested information;

(vi) a statement that the request is in conformity with the laws and administrative practices of the applicant party, and that if the requested information is within the jurisdiction of the applicant party, the Competent Authority of the applicant party would be able to obtain the information under the applicant party's law, or in the normal course of administrative practice; and

(vii) a statement that the applicant party has pursued all means available in its territory to obtain the information, except those giving rise to disproportionate difficulties.[86]

Moreover, a TIEA does not specify what is to be done if there are no appropriate domestic legal provisions to collect the information, much less an obligation to create new mechanisms to access information.[87]

Liechtenstein has signed TIEAs with the U.S., the United Kingdom, Belgium, France, Netherlands, Germany, Italy, and the four Nordic countries. The rest of the TIEAs have been signed with traditional financial offshore centers, including Antigua and Barbuda, Monaco, St. Kitts and Nevis and St. Vincent and the Grenadines. The Faroe Islands, which is not a Global Forum Member, has signed

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www.oecdinsights.org/2012/03/12/are-tax-havens-disappearing-yes-but-this-is-only-the-beginning.

[84] The last country to join the Global Forum was Ukraine on October 23, 2013. See http://www.kmu.gov.ua/control/publish/article?art_id=246785961 (accessed November 15, 2013).

[85] See http://www.oecd.org/ctp/treaties/article26oftheoecdmodeltaxconventiononincomeandcapital.htm (accessed November 15, 2013).

[86] Guest Author, "Are tax havens disappearing?" *OECD Insights*, March 12, 2012. www.oecdinsights.org/2012/03/12/are-tax-havens-disappearing-yes-but-this-is-only-the-beginning.

[87] Lee A. Sheppard, "Don't ask, don't tell. Part 4: Ineffectual information sharing", *Tax Notes Today*, March 23, 2009, pp. 1411–18.

38 TIEAs, exclusively with traditional tax-haven countries.[88] The Netherlands has signed 29 TIEAs but has made only 22 requests for fiscal information between June 1, 2008 and June 1, 2011.[89] Over half of these requests were made to Jersey, and a few to Guernsey. The finance ministry has only received seven replies from Jersey and three from Guernsey. No information has been released about the content and quality of the replies.

Commentators have noted that the OECD has focused on the quantity of signed TIEAs and not the quality of the signatories. The OECD has imposed a twelve-agreement threshold, but has not created (1) standards as to the quality and nature of the signatories, (2) an evaluation of the effectiveness of the implementation, and (3) an evaluation of whether the jurisdictions will continue to sign agreements after the threshold has been reached.[90] The OECD has indicated that a jurisdiction's twelve-agreement threshold needs to be reviewed to take into account the jurisdictions with which the agreements have been signed, the willingness of a jurisdiction to continue to sign agreements even after it has reached this threshold, and the effectiveness of implementation. However, there is no date to review this standard and no previsions about how many of the traditionally "uncooperative" countries which have succeeded in signing twelve information-exchange agreements will be able to maintain this standard in the future.[91] With an evolving standard toward automatic exchange via the U.S. FATCA intergovernmental agreement initiative and the OECD TRACE initiative, such a review may become moot.

Article 26 of the OECD Model Convention was modified in July 2012 to allow the competent authorities of Contracting States to use information received for tax purposes for non-tax purposes provided such use is allowed under the laws of both States and the competent authority of the supplying State authorizes such use. Moreover, and also important, the Commentary was expanded to develop the interpretation of the standard of "foreseeable relevance" and the term "fishing expeditions", including with respect to a group of taxpayers not individually identified.[92]

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[88] See http://www.oecd.org/countries/faeroeislands/taxinformationexchangeagreementstieas.htm (accessed November 15, 2013).

[89] See http://www.eoi-tax.org/jurisdictions/NL#agreements (accessed November 15, 2013).

[90] Alberto Gil Soriano, *Toward an Automatic but Asymmetric Exchange of Tax Information: The US Foreign Account Tax Compliance Act (FATCA) as Inflection Point*, INTERTAX, Amsterdam: Wolters Kluwer, 542 (2012).

[91] Marie Therese Yates et al. "Death of information-exchange agreements? Part 3", (2011) *Journal of International Taxation*, vol. 22, p. 53.

[92] It is now possible to make a request for information relating to a group of taxpayers not individually identified provided that the requesting State provides a detailed description of the group and the specific facts and circumstances that have led to the request, an explanation of the applicable law, and why there is reason to believe, supported by a clear factual basis, that the taxpayers in the group for whom information is requested have been non-compliant with that law. It further requires a showing that the requested information would assist in determining compliance by the taxpayers

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The U.S. utilizes more than 61 tax treaties and 30 TIEAs to obtain tax information on its citizens.[93] Article 26 of the U.S. Model Income Tax Convention states that treaty partners "shall exchange such information as may be relevant for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes of every kind . . . including information relating to the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, such taxes." Article 26 allows a treaty partner to refuse to share information in limited situations, e.g., obtaining the information would violate the country's laws.[94] The U.S. has 56 Mutual Legal Assistance Treaties (MLATs) in force and several equivalent agreements. MLATs, however, are limited to providing assistance in criminal investigations and prosecutions. As most U.S. tax matters are civil instead of criminal, MLATs are more restrictive for tax information exchanges.[95]

See Chapter 18 for a detailed explanation of current OECD developments regarding information exchange.

[2] Automatic Exchange of Information: The New Standard As Of 2014?

The G20 London summit of April 2009 has been considered as an inflection point in the field of the international exchange of information.[96] The G20 London summit began a series of statements, and also concrete actions, toward initiating automatic exchange of information as the new international standard.

> 15. To this end [strengthening financial supervision and regulation] we are implementing the Action Plan agreed at our last meeting [Strengthening financial supervision and regulation], as set out in the attached progress report. We have today also issued a Declaration, Strengthening the Financial System. In particular we agree: [. . .]
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> —to take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over. We note that the OECD has today published a list of countries assessed by the Global

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in the group. See http://www.oecd.org/ctp/exchange-of-tax-information/Article%2026_QA.pdf (accessed November 15, 2014).

[93] Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance*, July 17, 2008. See www.levin.senate.gov/imo/media/doc/supporting/2008/071708PSIReport.pdf. See also www.irs.gov for a list of tax treaties.

[94] Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance*, July 17, 2008. See www.levin.senate.gov/imo/media/doc/supporting/2008/071708PSIReport.pdf. See also www.irs.gov for a list of tax treaties.

[95] Subcommittee on Investigations, *Tax Haven Banks and U.S. Tax Compliance,* July 17, 2008. See www.levin.senate.gov/imo/media/doc/supporting/2008/071708PSIReport.pdf. See also www.irs.gov for a list of tax treaties.

[96] London G20 Summit, Leader's statement, April 2, 2009, See http://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf (accessed November 15, 2013).

Forum against the international standard for exchange of tax information

The final declaration of the G20 meeting of September 2009, held in Pittsburgh, included a statement made in the same terms, similar to the affirmation made by Nicolas Sarkozy on the eve of the summit saying that "*[t]ax havens, bank secrecy, that's all over*".[97]

> 15. Our commitment to fight non-cooperative jurisdictions (NCJs) has produced impressive results. We are committed to maintain the momentum in dealing with tax havens, money laundering, proceeds of corruption, terrorist financing, and prudential standards. We welcome the expansion of the Global Forum on Transparency and Exchange of Information, including the participation of developing countries, and welcome the agreement to deliver an effective program of peer review. The main focus of the Forum's work will be to improve tax transparency and exchange of information so that countries can fully enforce their tax laws to protect their tax base. We stand ready to use countermeasures against tax havens from March 2010. We welcome the progress made by the Financial Action Task Force (FATF) in the fight against money laundering and terrorist financing and call upon the FATF to issue a public list of high risk jurisdictions by February 2010. We call on the FSB to report progress to address NCJs with regards to international cooperation and information exchange in November 2009 and to initiate a peer review process by February 2010.

On October 29, 2011 the OECD published the report "The Era of Bank Secrecy is Over",[98] encouraging all the countries to transition towards a multilateral environment of exchange of information based on a network of bilateral treaties and to improve the effectiveness of the automatic exchange of information. Six days later, on the occasion of the Cannes G20 summit, all the G20 countries reached an agreement to sign the OECD—Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax matters:

> 35. We are committed to protect our public finances and the global financial system from the risks posed by tax havens and non-cooperative jurisdictions. The damage caused is particularly important for the least developed countries. Today we reviewed progress made in the three following areas:
>
> [. . .] We underline in particular the importance of comprehensive tax information exchange and encourage competent authorities to continue their work in the Global Forum to assess and better define the means to improve it. We welcome the commitment made by all of us to sign the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and strongly

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[97] "Sarkozy to Push G20 on Tax Havens Sanctions", September 23, 2009. See AFP http://www.google.com/hostednews/afp/article/ALeqM5jSY9nuPRQPJyKpipL5GY-5-cb4UA (accessed November 15, 2013).

[98] OECD (2011), The Era of Bank Secrecy is Over, October 26, 2011. See http://www.oecd.org/tax/exchange-of-tax-information/48996146.pdf (accessed November 15, 2013).

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> encourage other jurisdictions to join this Convention. In this context, we will consider exchanging information automatically on a voluntary basis as appropriate and as provided for in the convention.

On February 26, 2012, the G20 Finance Ministers requested an update of the measures addressed to improve the exchange of information, including the automatic exchange of information.[99]

> 9. [. . .] We call upon all countries to join the Global Forum on transparency and to sign on the Multilateral Convention on Mutual Assistance. We call for an interim report and update by the OECD on necessary steps to improve comprehensive information exchange, including automatic exchange of information and, together with the FATF, on steps taken to prevent the misuse of corporate vehicles and improve interagency cooperation in the fight against illicit activities.

On June 2012, the OECD issued the two reports "Tackling Offshore Tax Evasion"[100] and "Automatic Exchange of Information. What It Is, How It Works, Benefits, What Remains To Be Done."[101] The G20 leaders endorsed the initiative, encouraging all the States to adopt this increasing trend:[102]

> 48. [. . .] We welcome the OECD report on the practice of automatic information exchange, where we will continue to lead by example in implementing this practice. We call on countries to join this growing practice as appropriate and strongly encourage all jurisdictions to sign the Multilateral Convention on Mutual Administrative Assistance.

The political support increased in the Finance Ministers and Central Banks Governors meetings of November 2012 and February 2013, where it was stated that:

> [w]e will continue to implement practices of automatic exchange of information and call on the OECD to analyze the safeguards, mechanisms and milestones necessary to increase its use and efficient implementation in a multilateral context[103]

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[99] Meeting of Finance Ministers and Central Bank Governors, Mexico City. Communiqué, February 26, 2012. See http://www.g20.utoronto.ca/2012/2012-120226-finance-en.html (accessed November 15, 2013).

[100] OECD (2012), *Tackling offshore tax evasion. The G20/OECD continues to make progress. Secretary-General Report to the G20 Finance Ministers*, June of 2012, http://www.s4tp.org/wp-content/uploads/2012/07/Tackling-Offshore-Tax-Evasion-OECD-publication-Jun-2012.pdf (accessed November 15, 2013).

[101] OECD (2012), *Automatic Exchange of Tax Information. What It Is, How It Works, Benefits, What Remains to Be Done*", June 2012, See http://www.oecd.org/ctp/exchange-of-tax-information/AEOI_FINAL_with%20cover_WEB.pdf (accessed November 15, 2013).

[102] G20 Leaders Declaration. Los Cabos, México, June 18-19, 2012. See http://g20mexico.org/images/stories/temp/G20_Leaders_Declaration_2012.pdf (accessed November 15, 2013).

[103] Communiqué of Meeting of G20 Finance Ministers and Central Bank Governors, México,

> [. . .]
>
> [w]e reiterate our commitment to extending the practice of automatic exchange of information, as appropriate, and commend the progress made recently in this area. We support the OECD analysis for multilateral implementation in that domain.[104]

The G20 Finance Ministers and Central Banks Governors meeting of April 2013 was another milestone, as far as the automatic exchange of information was mentioned for the first time as the forthcoming international standard. In addition, the Global Forum was appointed as the responsible body for monitoring the compliance with this new standard:

> 14. [. . .] We welcome progress made towards automatic exchange of information which is expected to be the standard and urge all jurisdictions to move towards exchanging information automatically with their treaty partners, as appropriate. We look forward to the OECD working with G20 countries to report back on the progress in developing of a new multilateral standard on automatic exchange of information, taking into account country-specific characteristics. The Global Forum will be in charge of monitoring.

Following this, the OECD issued the report "A Step Change in Transparency" outlining four concrete steps needed to put in place a global, secure and cost effective model of automatic exchange of information:[105]

- Enact broad framework legislation;
- Select a legal basis for the exchange of information;
- Adapt the scope of the reporting and due diligence requirements and coordinate guidance to ensure consistency and reduce cost; and
- Develop common or compatible IT standards.

On June 2013, the G20 Finance Ministers and Central Banks Governors stated that the automatic exchange of information would be the new standard and detailed some measures and deadlines to implement such new standard in 2014 and 2015.

> 19. We commend the progress recently achieved in the area of tax transparency and we fully endorse the OECD proposal for a truly global model for

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November 5, 2012, paragraph 21, See http://www.g20.utoronto.ca/2012/2012-121105-finance-en.html (accessed November 15, 2013).

[104] Communiqué of Meeting of G20 Finance Ministers and Central Bank Governors, Moscow, February 16, 2013, paragraph 20, See http://www.g20.utoronto.ca/2013/2013-0216-finance.html (accessed November 15, 2013).

[105] OECD, *A Step Change in Transparency. Delivering a standardized secure and cost effective model of bilateral automatic exchange for the multilateral context. OECD Report for the G8 Summit*, June 2013, See http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf (accessed November 15, 2013).

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> multilateral and bilateral automatic exchange of information. We are committed to automatic exchange of information as the new, global standard and we fully support the OECD work with G20 countries aimed at setting such a new single global standard for automatic exchange of information. We ask the OECD to prepare a progress report by our next meeting, including a timeline for completing this work in 2014. We call on all jurisdictions to commit to implement this standard. We are committed to making automatic exchange of information attainable by all countries, including low-income countries, and will seek to provide capacity building support for them. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale. All countries must benefit from the new transparent environment and we call on the Global Forum on Exchange of Information for Tax Purposes to work with the OECD task force on tax and development, the World Bank Group and others to help developing countries identify their need for technical assistance and capacity building. We are looking forward to the Global Forum establishing a mechanism to monitor and review the implementation of the global standard on automatic exchange of information.

The G8 leaders in turn ratified their will to establish the automatic exchange of information as the new standard and develop a multilateral environment enabling the prosecution and punishment of the tax evaders:[106]

> We commit to establish the automatic exchange of information between tax authorities as the new global standard, and will work with the Organization for Economic Cooperation and Development (OECD) to develop rapidly a multilateral model which will make it easier for governments to find and punish tax evaders.

The G20 summit of September 2013 was also decisive: the automatic exchange of information was ratified as the coming new standard and established concrete deadlines to carry out its implementation. The new standard will be presented in February 2014, the modalities of exchange will be defined in mid-2014 and these will be implemented before the end of 2015:[107]

> 51. We commend the progress recently achieved in the area of tax transparency and we fully endorse the OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard, which must

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[106] G8 Lough Erne Communiqué, June 18, 2013, See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207771/Lough_Erne_2013_G8_Leaders_Communique.pdf (accessed November 15, 2013).

[107] Saint Petersburg G20 Leaders' Declaration, September 6, 2013, http://en.g20russia.ru/load/782795034. See also the OECD Secretary General Report to the G20 Leaders. See http://www.oecd.org/ctp/SG-report-G20-Leaders-StPetersburg.pdf (accessed November 15, 2013).

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> ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. We call on all countries to join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters without further delay. We look forward to the practical and full implementation of the new standard on a global scale. We encourage the Global Forum to complete the allocation of comprehensive country ratings regarding the effective implementation of information exchange upon request and ensure that the implementation of the standards are monitored on a continuous basis.

The G20 leaders' declaration included, among others, a fiscal annex whose paragraph 51 detailed the abovementioned statement:[108]

> 3. The G20 has now endorsed the development of a new global tax standard: to automatic exchange of information. [. . .] Given the developments in the Global Forum and other recent advances, it is now time to migrate to a more ambitious, more efficient and higher standard, which is automatic exchange of information. Recent developments involving undisclosed foreign bank accounts have also highlighted the urgent need to move to this new standard which the Global Forum will monitor to ensure its effective implementation. [. . .] The OECD has initiated work with G20 countries to develop the new single global standard for automatic exchange of information. G20 Finance Ministers and Central Bank Governors have mandated the OECD to provide a progress report at the October Finance Ministers' meeting, including a timeline for completing this work in 2014. The new standard (included in a Model Competent Authority Agreement) will be presented at G20 Finance Ministers and Central Bank Governors' meeting in February 2014. There is a clear need for the practical and full implementation of this new tax standard on a global scale. The Global Forum will establish a mechanism to monitor and review the implementation of the new standard on automatic exchange of information and will be working with the OECD Task Force on Tax and Development, the World Bank Group and others to help developing countries identify their need for technical assistance and capacity building.
>
> 4. The next challenge regarding automatic exchange of information is now to get all jurisdictions to commit to this standard and put it into practice. Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard, which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at

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[108] Tax annex to the Saint Petersburg G20 Leaders' Declaration, September 5, 2013. See http://en.g20russia.ru/load/782804366 (accessed November 15, 2013).

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presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. The multilateral Convention is key to ensuring rapid implementation of the new standard and to enabling developing countries to benefit from the new more transparent environment. [. . .]. We expect all jurisdictions to join the Convention without further delay.

§ 1.12 JOINT INTERNATIONAL TAX SHELTER ENFORCEMENT EFFORTS

The Joint International Tax Shelter Information Centre (JITSIC) was formed in 2004 by Austria, Canada, the U.K., and the U.S. to share cross-border information on tax schemes. Japan joined the initiative in 2007.[109] The exchange of information has resulted in the JITSIC tackling abusive tax schemes involved in retirement account withdrawals, financial transactions for creating inappropriate foreign tax credits, and futures and options transactions for false tax credit benefits.[110]

§ 1.13 RELEASE OF FATCA

The Foreign Account Tax Compliance Act (FATCA) was included in the Hiring Incentives to Restore Employment (HIRE) Act. FATCA was aimed at offsetting the projected revenue losses derived from these hiring incentives by improving detection of and discouraging tax evasion. It consisted in part of Chapter 4 to Subtitle A of the Internal Revenue Code (the "Code"), implementing a new reporting and withholding system, only avoidable if foreign financial institutions (FFIs) sign with the IRS the so-called "IRC Code Section 1471(b) agreement," now known as a "FFI Agreement".

Before the proposed regulations were issued, the U.S. Treasury and the IRS released Notice 2010-60[111] on August 29, 2010, which provided guidance on the implementation of Chapter 4 and requested comments. On April 8, 2011, the Treasury and IRS released Notice 2011-34,[112] which modified the guidance in Notice 2010-60. The Treasury and IRS received comments and complaints related to the timeline for developing compliance, the reporting and withholding necessary to comply with Chapter 4, and the implementation notices.

The Treasury and IRS decided on a phased implementation of Chapter 4 and

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[109] For information on the mission of the JITSIC, *see Joint International Tax Shelter Information Memorandum of Understanding for the Creation of a Joint International Tax Shelter Information Center*, www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf (accessed November 15, 2014).

[110] Subcommittee on Investigations, *supra* at 31.

[111] IRS Notice 2010-60. http://www.irs.gov/pub/irs-drop/n-10-60.pdf. Accessed February 20, 2012.

[112] IRS Notice 2011-34. http://www.irs.gov/pub/irs-drop/n-11-34.pdf. Accessed February 20, 2012.

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issued Notice 2011-53.[113] It outlined a timeline for the implementation of Chapter 4 and discussed substantive and procedural matters affected by the regulations. It provided timelines to phase in the following requirements:

(i) Entering into a foreign financial institution agreement;

(ii) Performing due diligence requirements with respect to U.S. accounts;

(iii) Reporting U.S. accounts;

(iv) Withholding from payments and issuing regulations; and

(v) Implementation of the FFI agreement and various reporting forms.

On February 8, 2012, the Treasury and the IRS issued the proposed FATCA regulations regarding information reporting by FFIs with respect to U.S. accounts and withholding on certain payments to FFIs and other foreign entities.

Final Regulations were issued on January 17, 2013, confirming the timelines set forth in Announcement 2012-42 and introducing some changes, such as the extension of the grandfather date to January 1, 2014, the creation of new categories of exempted and deemed-compliant entities, and new rules for insurance contracts and companies.

However, Notice 2013-42, issued on July 12, 2013, provided revised timelines for the implementation of FATCA as well as additional guidance concerning the treatment of financial institutions located in jurisdictions that have signed intergovernmental agreements for the implementation of FATCA but have not yet brought those IGAs into force.

§ 1.14 JOINT STATEMENT ON AN INTERGOVERNMENTAL APPROACH AND THE MODEL AGREEMENT

On February 8, 2012, the Treasury and the IRS issued a joint statement regarding an intergovernmental approach with five major trading partners of the U.S. with respect to improving international tax compliance and implementing FATCA. The Joint Statement with the governments of France, Germany, Italy, Spain and the U.K. on an intergovernmental approach to implementing FATCA resulted in enhanced cooperation and softened FATCA implementation for their financial institutions.

The joint statement and intergovernmental approach acknowledges the reality of serious conflicts between the reporting requirements of FATCA and the domestic laws of the foreign jurisdictions. The intergovernmental approach consists of the reporting requirements being made through a mutual assistance in tax matters infrastructure between countries rather than direct reporting of a financial institution to the U.S. Treasury.

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[113] IRS Notice 2011-53. http://www.irs.gov/pub/irs-drop/n-11-53.pdf. Accessed February 20, 2012.

On July 25, 2012, four U.S. Senators sent a letter to Treasury Secretary Geithner with rather pointed questions as to authority, effect on U.S. institutions, cost, information privacy, and role of international organizations. A 30 day deadline was specified. No reply was provided and Senator Rand Paul sought a vote of no confidence on November 3, 2012. Since then Secretary Geithner has retired and Secretary Lew has replaced him. After the Democratic controlled Senate voted to allow Secretary Lew to serve on international monetary boards, Senator Paul said he would put a hold on the nomination of Janet Yellen to lead the Federal Reserve.[114]

In May, Senator Paul introduced a bill to repeal the anti-privacy provisions of FATCA. He stated, "FATCA is a textbook example of a bad law that doesn't achieve its stated purpose but does manage to unleash a host of unanticipated destructive consequences . . . FATCA should be repealed and Congress should find a less onerous means of enforcing tax laws."[115]

The U.S. Treasury later issued two other joint statements with Switzerland and Japan regarding the model intergovernmental agreement to improve tax compliance and implement FATCA.

In short, the intergovernmental approach establishes another version of an automatic exchange of information. Pursuant to the joint statements, France, Germany, Italy, Spain and the U.K. agreed to alter their national legislation to require FFIs to garner the FATCA information and identify U.S. accounts. To date, their intentions to enact enabling legislation have remained just that.

If the IGAs with reciprocity provisions are agreed to, then information will be shared with the U.S. on an automatic basis. Domestic tax authorities will have the same information that is being provided to the IRS on domestic taxpayers. FFIs will not be required to terminate the account of an account holder or impose withholding on passthru payments. The U.S. will not require each FFI to enter into a separate agreement. The U.S. acquires a commitment of reciprocity with respect to the information on the U.S. accounts of residents of the FATCA partners. The model agreement moves the unilateral nature of FATCA to an instrument for U.S. bilateral automatic exchange of information. FFIs will provide the information to the foreign government, and the foreign government will provide that information to the U.S.

Two primary versions of model agreements exist: a reciprocal version and a non-reciprocal version. Both versions establish a framework for financial institution reports of certain account information to their respective tax authorities, followed by automatic exchange of such information under existing bilateral tax treaties or tax information exchange agreements. However, in practice each model agreement is separately negotiated and will vary accordingly.

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[114] The Hill, Senate votes to allow Lew to serve on international boards, October 30, 2013.

[115] Sen. Paul Introduces Bill to Repeal Anti-Privacy Provisions in FATCA. May 8, 2013. Available at http://www.paul.senate.gov/?p=press_release&id=793 (accessed November 15, 2013).

The reciprocal version of the model also provides for the U.S. to exchange information currently collected on accounts held in U.S. financial institutions by residents of partner countries. This version includes a policy commitment to pursue regulations and support legislation that would provide for equivalent levels of exchange by the U.S. Although the Treasury says it has authority, nonetheless, President Obama's 2014 Budget contains a provision which, if enacted by Congress, would then confirm onto Treasury the authority which it claims to already have.[116]

This version of the model agreement will be available only to jurisdictions with whom the U.S. has in effect an income tax treaty or tax information exchange agreement and with respect to whom the Treasury Department and the IRS have determined that the recipient government has in place robust protections and practices to ensure that the information remains confidential and that it is used solely for tax purposes. The U.S. will make this determination on a case-by-case basis.

Currently, as of November 30, 2013, there are twelve intergovernmental agreements signed: United Kingdom, Denmark, Mexico, Ireland, Switzerland, Norway, Spain, France, Germany, Costa Rica, Cayman Islands, and Japan. Only the Mexican IGA has entered into force because it did not need a ratification process. Sixteen more IGAs have been initialed or completed negotiation but are not yet officially signed, such as Hungary and Bermuda.[117] On November 14, the IGA with France was published on the U.S. Treasury website, and on November 26 and 29 with Costa Rica and Cayman Islands respectively.[118] The U.S.—France IGA is, in effect, an agreement to agree if the respective countries' law allows it, in which case it will become effective in 2017. There are also IGA negotiations with more than 75 countries.

See Chapter 15 for a detailed analysis of the framework of the intergovern-

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[116] In many cases, foreign law would prevent foreign financial institutions from complying with the FATCA provisions of the Hiring Incentives to Restore Employment Act of 2010 by reporting to the IRS information about U.S. accounts. Such legal impediments can be addressed through intergovernmental agreements under which the foreign government agrees to provide the information required by FATCA to the IRS. Requiring U.S. financial institutions to report similar information to the IRS with respect to nonresident accounts would facilitate such intergovernmental cooperation by enabling the IRS to reciprocate in appropriate circumstances by exchanging similar information with cooperative foreign governments to support their efforts to address tax evasion by their residents. The proposal would provide the Secretary of the Treasury with authority to prescribe regulations that would require reporting of information with respect to nonresident alien individuals, entities that are not U.S. persons, and certain U.S. entities held in substantial part by non-U.S. owners, including information regarding account balances and payments made with respect to accounts held by such persons and entities.

[117] See http://www.treasury.gov/press-center/press-releases/Pages/jl2226.aspx (accessed November 30, 2013).

[118] http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/BilateralAgreementUSFranceImplementFATCA.pdf (accessed November 15, 2013).

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mental agreement models, Chapter 16 for an analysis of the provisions of current intergovernmental agreements, and Chapters 24, 22, 21, and 23 for the national application of the intergovernmental agreements for the United Kingdom, Mexico, Japan, and Switzerland, respectively.

§ 1.15 POLITICAL PUSH BACK

[1] Congressional Push Back and the U.S. Treasury Response

The Joint Statement between the U.S., France, Germany, Italy, Spain and the United Kingdom regarding an intergovernmental approach to improving international tax compliance and implementing FATCA laid the foundation for the U.S. commitment to share the same information requested from the other States.[119] Senators Paul, DeMint, Lee and Chambliss sent a letter to the U.S. Treasury Secretary on July 25, 2012 asking him to clarify the scope of this commitment of reciprocity, its legal basis and other issues, including the estimated costs, if any, of FATCA for U.S. Financial institutions:

> 1. Does the Treasury Department anticipate that meeting the commitment in the Joint Statement to require U.S. financial institutions to collect and report information on the accounts of residents of FATCA partner countries would necessitate enactment of legislation to that end by Congress or amendments to existing tax treaties, or does the Department believe it already has sufficient statutory authority to issue regulations to that end without further action by Congress?
>
> 2. If the Department anticipates that Congressional action is needed for that purpose, when do you anticipate such legislation would be proposed or tax treaty amendments submitted for the Senate's advice and consent; or, if you believe sufficient authority already exists, when do you anticipate draft regulations would be issued for public view, including draft regulations that would require domestic U.S. financial institutions to collect and report information on accounts of residents of partner countries?
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> 3. If you believe the Department already has sufficient statutory authority to issue regulations requiring U.S. financial institutions to collect and report the information described in the Joint Statement, cite and provide relevant text of the statutes conferring such authority.

Assistant Secretary for Tax Policy of the U.S. Treasury, Mark J. Mazur, answered on October 10, 2012 providing clarifications and also exposing the limitations of the current legislative framework under which the U.S.' commit-

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[119] U.S. Treasury, *Joint Statement from the United States, France, Germany, Italy, Spain and the United Kingdom regarding an intergovernmental approach to improving international tax compliance and implementing FATCA*, February 8, 2012, See http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf (accessed November 15, 2013).

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ment for reciprocity is not currently possible:[120]

> The United States cannot expect foreign governments with shared policy goals and practices regarding transparency and fairness to facilitate the reporting of the information required under FATCA by their financial institutions if we are unwilling to help address tax evasion under their tax systems. We think the most straightforward approach would be to share information, in appropriate circumstances, that pursuant to existing law already must be reported to the IRS about accounts held by their residents in the United States.
>
> [. . .]
>
> Section 6103(k)(4) of the Internal Revenue Code authorizes the IRS to share information it collects with a foreign government, but only if the United States has in effect an income tax treaty or tax information exchange agreement with the foreign jurisdiction. Therefore, the Treasury Department will only enter into the reciprocal version of the Model Agreement with jurisdictions with which the United States has in effect such an agreement. Additionally, among those jurisdictions, the reciprocal version will be used only with foreign governments that the Treasury Department and the IRS have determined have robust protections and practices in place to ensure that exchanged information will remain confidential and will be used solely for tax purposes.
>
> [. . .]
>
> While the reciprocal version of the Model Agreement includes a policy commitment to pursue equivalent levels of reciprocal automatic exchange in the future, no additional obligations will be imposed on U.S. financial institutions unless and until additional laws or regulations are adopted in the United States.

A serious question has arisen as to the legality of any Intergovernmental Agreements (IGAs) and specifically any provision for reciprocity.[121] If IGAs are not valid then it is highly unlikely that any FFI would sign a FFI Agreement.[122]

Algirdas Šemeta, the EU Commissioner on Taxation and Customs Union, in

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[120] See http://isaacbrocksociety.ca/wp-content/uploads/2012/11/12SE001798-SIGNED-Paul.pdf (accessed November 15, 2013).

[121] Tax Notes Int'l. The Dubious Legal Pedigree of IGAs (And Why It Matters), p. 565, February 11, 2013.

[122] A lively and interesting discussion of FATCA IGAs is contained in Repeal FATCA.com, "FATCA Intergovernmental Agreements Exposed as Bad Deal for Partner Countries" at http://www.repealfatca.com/index.asp?idmenu=4&title=news&idsubmenu=112 (accessed November 15, 2013). See also an interesting observation on why the U.S. is not engaged in information sharing with Latin American countries and why many nations avoid signing a tax treaty at 2013 TNT 14-2 (Doc 2013-1162), News Analysis; Will U.S. Hypocrisy on Information Sharing Continue? Lee A. Shepard, January 17, 2013.

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turn, stated the EU Member States have signed an intergovernmental agreement model 1A precisely because of the reciprocity commitment:

> My point here is very clear: When countries negotiate a model 1 agreement, for exchange of information between governments [under FATCA], then the reciprocity is not only promised but also ensured by the United States.

[2] Senate Bill S.887—"To repeal the violation of sovereign nations' laws and privacy matters"

Sen. Rand Paul (R-Kentucky), leading the political opposition against FATCA, on May 7, 2013 introduced a Senate Bill proposing the derogation of FATCA. Among other measures, the Bill also seeks the repeal of the obligation to report Specified Foreign Financial Assets set out by Section 6038D of the IRC via Form 8938.[123] The rationale of this bill was explained in a letter sent to the rest of his Senator colleagues:[124]

> FATCA has had the practical effect of forcing FFIs to relinquish any association with American customers, and to avoid direct investment in the United States. It goes without saying that overseas investment in the U.S. is an important engine of our economic growth and prosperity. FATCA endangers an estimated $25 trillion in foreign capital currently invested in the U.S.
>
> [. . .]
>
> Perhaps even more troubling, the implementation of FATCA has allowed the Treasury Department to make independent decisions with respect to the sovereignty of foreign nations and the privacy of United States citizens. In order to implement this law, the Treasury has initiated intergovernmental agreements (IGAs), citing the intent to engage in reciprocal information sharing with other nations. The Treasury Department, without the consent and authority of Congress, will force U.S. financial institutions to provide the bank account information of private customers to foreign nations. Such a requirement not only diminishes U.S. privacy protections, but also imposes billions of dollars in compliance costs here at home, which will be passed onto customers and the American public.

The letter has been endorsed by some lobby groups such as the Credit Union National Association,[125] the Coalition for Tax Competition,[126] the Center for

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[123] Chart with the main differences between form 8939 and form TD F 90-22.1 available at http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

[124] Letter of Senator Rand Paul of April 25, 2013, http://www.repealfatca.com/downloads/Dear_Colleague_FATCA_Repeal.pdf (accessed November 15, 2013). See also "Senator Rand Paul introduces Bill to repeal FATCA", *The Wall Street Journal*, May 8, 2013, http://online.wsj.com/article/PR-CO-20130508-914454.html (accessed November 15, 2013).

[125] See www.cuna.org/Legislative-And-Regulatory-Advocacy/DownLoads/congress_letter_050813/ (accessed November 15, 2013).

Freedom and Prosperity and the National Taxpayers Union, among others.[127] Nevertheless, the current Democrat majority in the Senate establishes a roadblock for the Bill to be enacted.[128] Congressman Bill Posey made reference to introducing legislation in his letter sent to the U.S. Treasury Secretary on July 1, 2013:[129]

> Legislation to repeal FATCA was recently introduced in the Senate, and I expect a companion bill will soon be introduced in the House of Representatives.

Congressman Posey has introduced H.R. 229 in response to the Treasury issuing final regulations §1.6049-4(b)(5)(i) and §1.6049-8 applicable after January 1, 2013 to require U.S. banks to report on interest payments paid to nonresident aliens. H.R. 229 would prohibit the Secretary from requiring a payor of interest to file an information return on interest that is not effectively connected with a trade or business within the United States and that is paid to a nonresident alien on a deposit maintained at an office within the United States and that is paid to a nonresident alien on a deposit within the United States.[130] Senator Marco Rubio has introduced a companion bill 5.1506 in the Senate.

Treasury Regulations §§1.6049-4(b)(5)(i) and 1.6049-8 have been challenged in court by Texas and Florida banks to block reciprocal implementation information gathering on foreigners holding deposits in U.S. banks.[131] It is noted that this court challenge by Texas and Florida banks "threatens to undermine a broad U.S. government crackdown on offshore tax avoidance and jeopardize a web of carefully crafted international agreements . . ."

The new regulations for nonresident interest reporting have certain and quite significant restrictions.[132]

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[126] See http://freedomandprosperity.org/files/fatca/CTC-FATCA_06-06-2013.pdf (accessed November 15, 2013).

[127] James G. Jatras, "Senator Rand Paul introduces Bill to repeal FATCA", *Repealfatca.com*, May 8, 2013. See http://www.repealfatca.com/index.asp?idmenu=4&title=News&idsubmenu=124 (accessed November 15, 2013).

[128] Maxime Fischer-Zernin, "Rand Paul 2016: Fight against tax-haven Bill could hint at presidential run", *PolicyMic*, May 10, 2013. See http://www.policymic.com/articles/40875/rand-paul-2016-fight-against-tax-haven-bill-could-hint-at-presidential-run (accessed November 15, 2013).

[129] Letter of Senator Bill Posey addressed to the U.S. Treasury Secretary, Jack Lew, of July 1, 2013, See http://www.repealfatca.com/downloads/Posey_letter_to_Sec._Lew_July_1,_2013.pdf (accessed November 15, 2013).

[130] *See* http://beta.contress.gov/bill/113th/house-bill/2299 (accessed November 15, 2013).

[131] *See* Jack Townsend's Blog, http://federaltaxcrimes.blogspot.com/2013/11/45-banks-file-long-shot-litigation-to.html (accessed November 15, 2013.

[132] Guidance on Reporting Interest Paid to Nonresident Aliens, 77 Fed Reg 23, 391 (Apr. 19, 2012) to be codified at 2-6 C.F.B. pts. 1 and 31.

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§ 1.16 MILESTONES IN DATE ORDER

2010:

March 18: U.S. Congress passed the FATCA legislation.

August 27: Notice 2010-60, 2010-37 IRB 329 provided preliminary guidance.

2011:

April 8: Notice 2011-34, 2011-19 IRB 765.

July 14: Notice 2011-53 released modifying Notice 2011-34 and timeline for implementation.

2012:

February 8: IRS issued draft regulations and joint intergovernmental statement.

July 26: IRS issued draft Model Intergovernmental Agreement (Model 1).

September 12: U.S. and U.K. sign agreement on international tax compliance and FATCA implementation.

October 24: The IRS issued Announcement 2012-42 with new timelines for due diligence procedures and further guidance concerning gross proceeds withholding.

November 15: IRS issued draft Model Intergovernmental Agreement (Model 2).

2013:

January 1: FATCA commencement date.[133]

January 17: IRS issued final regulations.

July 12: IRS issued Notice 2013-42, providing revised timelines and additional guidance concerning the treatment of financial institutions located in jurisdictions that have signed intergovernmental agreements for the implementation of FATCA but have not yet brought those IGAs into force.

August 19: FATCA Registration Portal for FFIs opened.

December 31: Qualified intermediaries (QIs), withholding foreign partnerships (WPs) and withholding foreign trusts (WTs) agreements expired on this date extended to June 30, 2014.

2014:

April 25: Last day for FFI to register on FATCA Registration Portal to be included on IRS' initial FFI List.

June 2: IRS expected to publish initial IRS FFI list (and monthly thereafter).

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[133] Grandfathered obligations regarding FATCA withholding are not required on obligations outstanding on January 1, 2014, unless they are materially modified subsequent to January 1, 2014, according to Reg § 1.1471-2(b)(2)(i)(A). Obligations to make a payment with respect to, or to repay, collateral posted to secure obligations under a Notional Principal Contract (NPC) that is a grandfathered obligation are also grandfathered.

June 30: Deadline for FFIs to enter an agreement. FFI agreement effective date.[134] Begin new customer onboarding and remediation for existing customers meeting FATCA requirements.

July 1: FATCA-compliant onboarding processes/systems for new accounts of both U.S. withholding agents ("USWAs") and FFIs must be operational. Accounts opened prior to January 1, 2014 will be considered "preexisting" for USWAs and FFI's.

July 1: FATCA withholding begins. USWAs (and other WAs) and PFFIs must withhold on U.S.-sourced FDAP payments to new accounts held by documented non-participating FFIs (NPFFIs). PFFIs must withhold on U.S.-sourced FDAP payments to recalcitrant accounts. Notice 2013-43 did not affect the timing provided in the final regulations for withholding on gross proceeds, passthru payments, and payments of U.S. source FDAP with respect to offshore obligations by persons not acting in an intermediary capacity.

July 1: USWA and FFI grandfathered obligation begins and exemption from FATCA withholding (but still required to report).

December 31: U.S. Withholding agents, participating FFIs and registered deemed-compliant FFIs must document pre-existing entity accounts identified as prima facie FFIs. If entered an agreement after July 1, 2014, the deadline is six months from the effective date of the FFI agreement.

2015:

January 1: Withhold on FDAP payments to undocumented NPFFIs (*prima facie* FFIs), provided that the PFFIs FFI agreement is approved by the IRS and effective on July 1, 2014.

March 15: 1042-S reporting for USWAs, WAs, and PFFIs.

March 31: WAs and USWAs begin reporting of U.S. substantial owners of passive NFFEs.

March 31: U.S. Account Reporting (Form 8966) for FFIs with respect to the 2014 calendar year (previously 2013 and 2014 calendar years).[135]

June 30: Identification procedures must document pre-existing high value individual accounts. If FFI agreement signed after July 1, 2014 the deadline is one year from the effective date of the agreement. (July 1, 2013 FFI agreements) accounts.

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[134] IRS Notice 2013-43, p. 7. The FFI Agreement of a PFFI that registers and receives a GIIN from the IRS on or before June 30, 2014, will have an effective date of June 30, 2014, effectively resulting in a six-month postponement of the deadlines for completing due diligence on preexisting obligations.

[135] IRS Notice 2013-43 modified the timeline to require reporting on March 31, 2015, only with respect to the 2014 calendar year for U.S. accounts identified by December 31, 2014.

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December 31: Complete due diligence for all remaining accounts.[136]

2016:

January 1: Begin withholding. PFFIs begin withholding on all recalcitrant individual accounts and undocumented entity accounts that were preexisting accounts. USWAs and WAs begin withholding on all undocumented entity accounts that were preexisting accounts.

January 1: Limited FFI exemption expires wherein local regulations prohibit FATCA compliance. Must become participating FFI to avoid other participating FFIs within an expanded affiliated group from losing their status.

March 15: PFFIs—Reporting begins on Form 1042-S for non-U.S. source payments made to NPFFIs for calendar year 2015.

March 31: PFFIs—Certain income information must be included in annual U.S. account reporting on Form 8966. Gross proceeds are still not reported.

June 30: U.S. Withholding Agents, PFFIs, RDCFFIs, must complete remediation and document pre-existing entity accounts not otherwise identified as a Prima Facie FFI.

June 30: PFFIs must document pre-existing non-high value accounts.

August 31: Due date for Responsible Officer due diligence certification, unless it has been previously submitted.

December 31: Final day of transitional rule treating U.S. source FDAP payment paid by non-intermediaries on offshore obligations as excluded from definition of "withholdable payment".

2017:

January 1: Withholding on gross proceeds begins for USWAs, WAs and PFFIs.

January 1: Withholding on foreign passthru payments.[137]

January 1: FATCA withholding on gross proceeds to non-participating FFIs and recalcitrant payees.

January 1: FFI grandfathered obligation cut-off for pass-thru payments.

March 15: FATCA reporting adds gross proceeds filed on Form 8961 for participating FFIs.

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[136] Pre-existing obligations: WAs, other than participating FFIs, will be required to document all remaining accounts by December 31, 2015. Undocumented entity accounts and payees will be treated as NPFFIs after that date. In addition, FFIs will be required to document all remaining accounts by December 31, 2015, or 6 months after the effective date of the FFI Agreement, whichever is later. Undocumented entity accounts and payees will be treated as NPFFIs, and undocumented individual account holders will be treated as recalcitrant after that date.

[137] Final regulations "reserved" on definition of "foreign passthru payments" in Reg § 1.1471-5(h)(2). Reg § 1.471-4(b)(4) provides that a FFI is not required to withhold on foreign passthru payments until January 1, 2017, or six months after the date of publication in the Federal Register of final regulations defining the term foreign passthru payments, whichever is later.

March 15: Source payment reporting begins on form 1042-S for non-participating FFIs.

2018:

March 31: Gross proceeds included. PFFIs, WAs and USWAs include gross proceeds subject to withholding on Forms 1042 and 1042-S.

June 30: Deadline for Responsible Officer to file certification for First Certification Period

§ 1.17 DEADLINES BY TOPIC

[1] Introduction

The proposed regulations, issued on February 8, 2012, taking into account the numerous comments received, sought to implement the reporting and withholding regime efficiently and effectively by establishing adequate lead times to allow system development and by minimizing the overall compliance burdens and to provide extensive guidance on all major aspects of the implementation. The final regulations incorporate and revise the guidance described in the FATCA Notices, as well as other topics not yet addressed. A revised timeline and other guidance regarding the Implementation of FATCA was issued by the IRS in Notice 2013-43. This Notice is quite detailed and complex.

[2] FFI Agreements

The Treasury Department and the IRS published a draft model FFI agreement in early 2012, and published a final model FFI agreement, incorporating comments received in the fall of 2012. On October 29, 2013 Treasury released Notice 2013-69: FFI agreement for Participating FFI and Reporting Model 2 FFI.[138] FFIs, from August 19, 2013, have started registering on the FATCA Registration Portal and have until April 25, 2013 to be included on the IRS' published FFI List to be issued in its first instance on June 2, 2014 and monthly thereafter. The FFI agreement will be finalized by December 31, 2013 and will enter into force June 30, 2014.

[3] Information Reporting Obligations

Pursuant to Notice 2011-53, only identifying information (name, address, TIN, and account number) and account balance or value of U.S. accounts was required to be reported by September 30, 2014 (with respect to 2013). Announcement 2012-42 postponed it until March 31, 2015 with respect to calendar years 2013 and 2014. Announcement 2013-43 postponed it again until March 31, 2015 and only with reporting for calendar year 2014 onward. Moreover, and due to the implementation difficulties faced, reporting on income will be phased in beginning in 2016 (with respect to the 2015 calendar year), and reporting on gross proceeds will begin in 2017 (with respect to the 2016 calendar year).

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[138] IRS Notice 2013-69. http://www.irs.gov/pub/irs-drop/n-13-69.pdf (accessed November 15, 2013).

[4] Withholding

U.S. sourced FDAP payments (of interest, dividends, etc.) to non-participating FFIs become subjected to 30 percent withholding from June 30, 2014. USWAs and WAs will then begin withholding on all undocumented entity accounts that were preexisting accounts on January 1, 2016, and U.S. sourced gross proceeds (e.g. repayment of principal) to non-participating FFIs will become subject to 30 percent withholding from January 1, 2017.

[5] Passthru Payments

The final regulations provide that withholding will not be required with respect to foreign passthru payments before the later of January 1, 2017 or six months after the date of publication in the Federal Register of final regulations defining the term "foreign passthru payments". Instead, as from January 1, 2015, it is required of participating FFIs to report annually to the IRS the aggregate amount of certain payments made to each nonparticipating FFI.

[6] "Grandfathering" Date

Section 501(d)(2) of the HIRE Act provided that no amount should be required to be deducted or withheld from any payment under any obligation outstanding on March 18, 2012, or from the gross proceeds from any disposition of such an obligation. With the final regulations and Notice 2013-43, the term "grandfathered obligation" means any obligation outstanding on July 1, 2014. However, final Treasury Regulations Section 1471-2(b)(2), according to what Announcement 2012-42 stated, broaden the scope of grandfathered obligations to include:

(i) Any obligation that produces or could produce a foreign passthru payment and that cannot produce a withholdable payment, provided that the obligation is outstanding as of the date that is six months after the date on which final regulations defining the term "foreign passthru payment" are filed with the Federal Register;

(ii) Any obligation that gives rise to a withholdable payment solely because the obligation is treated as giving rise to a dividend equivalent pursuant to Section 871(m) and the regulations thereunder, provided that the obligation is executed on or before the date that is six months after the date on which obligations of its type are first treated as giving rise to dividend equivalents; and

(iii) Any agreement requiring a secured party to make a payment with respect to, or to repay, collateral posted to secure a grandfathered obligation. If collateral (or a pool of collateral) secures both grandfathered obligations and obligations that are not grandfathered, the collateral posted to secure the grandfathered obligations must be determined by allocating (*pro rata* by value) the collateral (or each item comprising the pool of

collateral) to all outstanding obligations secured by the collateral (or pool of collateral).

[7] Transitional Rules for Members of Expanded Affiliated Groups

FATCA provides that the withholding, reporting, and other requirements imposed on an FFI shall apply with respect to all FFIs that are members of the same "expanded affiliated group". The regulations provide a two-year transitional period (until January 1, 2016) for the full implementation of these requirements in situations where an FFI affiliate is located in a jurisdiction that prohibits reporting or withholding under FATCA. However, the requirements will continue after that transitional period.

§ 1.18 PROBLEM AREA HIGHLIGHTS

[1] Doubt Arises to FATCA's Implementation

In 2010, both the Patient Protection and Affordable Care Act (a/k/a ACA or Obamacare) and the Foreign Account Compliance Tax Act were passed. Both are highly complex pieces of legislation involving the coordination through computer systems of a vast array of people and services, domestically and internationally, and on multiple levels.

As both the ACA and FATCA have rolled out, indisputable significant problems have arisen and are being widely recognized. Because the implementation problems are in a great many and substantial respects similar, if not identical, the experience learned and conclusions that can be reasonably drawn from either of them are instructional in analyzing actions that may need to be taken in the future by all relevant parties.

As to the ACA, on April 17, 2013 Senator Max Baucus (D-Montana), Chairman of the Senate Finance Committee called for the Secretary of Health and Human Services (HHS), Kathleen Sebelius, to testify on implementation and other issues. Secretary Sebelius had requested another $554 million for public relations to implement the ACA.

Senator Baucus asked Secretary Sebelius how HHS was possibly able to educate patients and providers about a new law that was "deeply confusing". He observed that he was "very concerned by lack of information and that accountants are 'throwing their hands' up over the law." Further, he stated, "I see a huge train wreck coming."[139]

Senate Majority Leader, Senator Harry Reid, has said, "Max said, 'unless we implement this properly it is going to be a train wreck,' and I agree with him."[140]

A November 11, 2013 editorial in the Chicago Tribune, the President's hometown newspaper, points out, "The architects of Obamacare brushed aside

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[139] Washington Times, Sen. Max Baucus: Health Law heading for "train wreck." Tom Howell Jr., Wednesday, April 17, 2013. Senator Baucus was the deciding vote in passing the ACA in 2010.

[140] Washington Times, Reid Agrees with Baucus, David Sherfinski, May 2, 2013.

sharp warnings from tech wizards that the computer system wasn't tested and ready. They piled hundreds of pages of last minute regulations on insurers." Further, as to the President, "He is losing the confidence and leaders in his own party." The editorial's concluding observation pretty well sums up the problem with the ACA. "It was a mistake to attempt such a massive government intrusion on a marketplace and a mistake to do so without anything close to a public consensus."[141]

FATCA is arguably also a massive government invasion of the financial marketplace, passed without valid public scrutiny. Looking to and comparing the real life results of the ACA is a conservative way of getting additional data on current real life results of FATCA.[142]

[2] Program Governance

FATCA will necessitate reordering of budget, personnel, and management across the enterprise and its many departments. Resources required for FATCA compliance will vary from nation to nation. Additional personnel will be needed to create and organize the data.[143] Financial institutions will be required to create and operate systems to determine and report on U.S. account holders.[144] These necessary changes will also require time and energy. The Japanese Bankers Association has raised the question of whether any success will be outweighed by the significant administrative, technical and financial burdens on FFIs in creating and collecting the information to detect American account holders.[145] Chapters 2 and 4 analyze program governance for information technology integration and at the institutional level, respectively.

[3] Legal Entity Analysis

The determination of the status of an entity for FATCA purposes will be difficult. Section 1471 definitions of a FFI received criticism. Critics felt that it was not practical to expect FFIs in an affiliated group to become a participating FFI or for the parent FFI of each group to oversee the compliance of each member of its group.

Notice 2010-60 provided guidance regarding the definition of a FFI under IRC Section 1471(d)(4). The Notice stated that because an entity falls under the

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[141] Chicago Tribune, Editorial: Truth Consequences and Obamacare, November 11, 2013.

[142] See New York Times Deal book blog, "Complying with U.S. Tax Evasion Law is Vexing Foreign Banks," Lynn Browning, September 16, 2013; and http://www.mlhorwitzlaw.com/blog/2013/09/is-fatca-a-train-wreck-but-bankers-are-afraid-to-object.shtml.

[143] Jessica Meek, *Banks Fear FATCA Raises Operational and Systemic Risks*, *Operational Risk & Regulation*, Risk.net, September 26, 2011. Available at http://www.risk.net/operational-risk-and-regulation/feature/2109648/banks-fear-fatca-raises-operational-systemic-risks.

[144] Jessica Meek, *Banks Fear FATCA Raises Operational and Systemic Risks*, *Operational Risk & Regulation*, Risk.net, September 26, 2011. Available at http://www.risk.net/operational-risk-and-regulation/feature/2109648/banks-fear-fatca-raises-operational-systemic-risks.

[145] Japanese Bankers Association (JBA), *supra*.

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banking laws of its country it does not mean that it falls under the regulations. The determination of whether an entity falls under the requirements of FATCA is difficult.

Institutions can be accused of being non-compliant when they do not have a connection with U.S. source income. Because of the possible risk of conflicts of law, certain institutions will not be able to report U.S. account holders because of local (non-U.S.) laws. These financial institutions will require time to revise their agreements with the existing customers or end their relationship with the customers. IGAs also modify the content and scope of the definition of FFI.

Chapter 7 addresses the complex characterization issues associated with FFIs and Chapter 15 contains analysis of the modified definitions of the model IGAs.

[4] Problems of Existing Account Information

Financial institutions have anti-money laundering/compliance systems already in place. These systems must be reprogrammed to satisfy FATCA requirements. Extant know-your-customer information can be used but will need to be expanded and improved.[146] A debate is occurring as to the extent that current, available KYC information can be leveraged but a review of the issue reveals weaknesses in the current system for FATCA purposes.[147] This challenge for KYC information systems is addressed in Chapters 2 and 3.

A foreign financial institution can enter into an agreement with the IRS and establish KYC procedures so as to participate in the QI program.[148] Uncovered in the Congressional Investigation of UBS, FFIs have since developed skills in the manipulation of their QI reporting obligation to avoid reporting U.S. client accounts to the IRS, which may have led to incomplete account information necessary for customer identification. More challenging for KYC systems, however, is that U.S. owners can shield their identities through foreign trusts, corporations, and other legal entities.[149] Chapter 3 addresses account information remediation whereas Chapter 6 addresses determining U.S. ownership under FATCA.

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[146] KPMG, *Banking Executives Expect Significant Cost Increases, Challenges Associated with FATCA Compliance: KPMG Survey.* Available at: http://www.prnewswire.com/news-releases/banking-executives-expect-signficant-costs-increase-challenges-associated-with-fatca-compliance-kpmg-survey-126318458.html.

[147] Ernst and Young, *Complying with FATCA: Eleven Key Challenges*. Available at http://www.ey.com/GL/en/Industries/Financial-Services/Banking—Capital-Markets/FATCA—Eleven-challenges-of-complying-with-FATCA.

[148] Ernst and Young, *Complying with FATCA: Eleven Key Challenges*. Available at http://www.ey.com/GL/en/Industries/Financial-Services/Banking—Capital-Markets/FATCA—Eleven-challenges-of-complying-with-FATCA.

[149] Ernst and Young, *Complying with FATCA: Eleven Key Challenges*. Available at http://www.ey.com/GL/en/Industries/Financial-Services/Banking—Capital-Markets/FATCA—Eleven-challenges-of-complying-with-FATCA.

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[5] Centralized Customer Data Issue

Few organizations have a single depository for information to make the determinations of the residence of account holders. Many FFIs do not have centralized customer data to determine which account holders need to be reported.[150] This situation is problematic for FFIs with affiliated groups, since the institutions will be dependent on affiliated financial institutions for the compilation of information. The foreign financial institutions could be held liable for the accuracy of the information provided by their affiliated foreign financial institutions.[151]

Jim Muir, in an article in *Global Banking and Finance Review*, made the following observations and recommendations:

> Client contact and communications will be crucial in the success of many of the FATCA programmes. It is imperative that FATCA programmes be designed to meet the evolving and changing nature of the regulatory landscape. Our advice to firms is to invest in technology to last for many years and not just to meet the "tick box" requirements of the immediate future. Some really tricky questions need [to be] answered operationally and from a compliance perspective including: How many times will we need to ask a client to respond before classifying them as recalcitrant? Will the frequency and duration of the attempt pass the "Treating Customers Fairly" test? Can we combine accounts and send one communication for them all or do we need to ask the same client the same question for each account? (Operational limitations due to a lack of a single customer view may leave us no choice.) Do we write to all addresses held on system or just the designated primary? Can we write to a joint account holder or disclose that the co-holder is a possible U.S. taxpayer? Do we start a widespread communications program ahead of the start of data gathering? What if clients provide the information now, before we are ready to capture it? Will this create a backlog? Where will we store physical (original?) documents, how do we retrieve and return when we have processed them? How do we phase the communications to the clients without being inundated with telephone enquiries? What length of time is reasonable to allow the client to present evidence? How do we start information gathering from new clients and cross refer it to existing clients? When do we start staff training to deal with queries? Do we have central teams capturing data or a distributed model? Access and ownership of relationships are related issues? For many of the larger institutions these questions are very complex indeed. The lack of existence of robust master customer data

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[150] Ernst and Young, *Complying with FATCA: Eleven Key Challenges*. Available at http://www.ey.com/GL/en/Industries/Financial-Services/Banking—Capital-Markets/FATCA—Eleven-challenges-of-complying-with-FATCA.

[151] Ernst and Young, *Complying with FATCA: Eleven Key Challenges*. Available at http://www.ey.com/GL/en/Industries/Financial-Services/Banking—Capital-Markets/FATCA—Eleven-challenges-of-complying-with-FATCA.

> management systems may mean that data has to be transferred between several systems and physical locations to avoid the customer being contacted several times.
>
> There will be a real risk of increased complaints and a concern about reputational damage and customer attrition. Many institutions will be aware that their customers have accounts with other institutions and they will not want to be compared unfavorably in terms of processes with other providers.
>
> I worry that many of the tactical and pragmatic first steps that can be taken are being delayed. Recently, some of the FATCA programs are being swallowed up into a larger "Financial Crime" agenda and forming a part of these larger programs. That is all very well. Unfortunately too many programs become too big (and too expensive) to deliver. If FATCA becomes relegated to a "work stream" in an enormous consultant-fest then, inevitably, focus will be lost. Of course, our institutions should look for synergies. Of course, FATCA, know-your-customer, and single customer view are all closely(!) related but the more moving parts to this program, the greater risk of failure.
>
> And the world doesn't stand still! What about the huge amount of "corporate activity" going on. LBG's branch disposal ("Verde") and RBS' "Rainbow" [are] tricky enough without the extra complexity of cut-over for FATCA (for example: at which point does the customer become the property of the receiver?). Even the consolidation of smaller mutuals will present challenges. The technology and the operational bandwidth will need to be flexible and scalable. The advice for UK firms is therefore simple: don't wait until these rules become effective to begin assessing your needs and associated costs for compliance. Instead, begin the evaluation and analysis of various case scenarios and records right now in order to identify which clients are at likely to be covered by FATCA, as well as the resulting tax implications. One thing is for sure: ignoring FATCA won't make it go away. In fact, the clock is already ticking.[152]

Chapter 4 addresses the institutional practical considerations for developing a FATCA compliance program, while Chapter 2 addresses the project management aspects of institutional information technology and software systems.

[6] The FATCA Clash with Data Protection Rules: Forthcoming New EU Directive on Data Protection?

National and EU data protection laws will conflict with the requirements of the FATCA legislation unless the FFI enters into an agreement with the U.S. account holder permitting the financial institution to share the information. Section 1471 requires that if a foreign law prevents disclosure by a FFI, then the FFI must get a waiver from the U.S. account holder, and if such a waiver is not obtained within

[152] Muir, Jim. "FATCA: A Few Days to Go," *Global Banking and Finance Review* (2012). http://www.globalbankingandfinance.com/infocus/infocus/966-fatca-few-days-to-go.html (accessed February 2013).

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a reasonable time, then the FFI must close the account.[153] The Directive 95/46/EC prevents the FFIs from providing the financial/personal data of their account holders to foreign governments without the written permission of the account holders.[154]

On October 21, 2013 the European Parliament approved its Compromise Text of the Proposed EU General Data Protection Regulation following four months of negotiations. Now it is up to the member states to agree on a position on the proposed regulation and start negotiations to finalize an agreement.

A serious problem arises when the FFI is not able to secure the permission of the account holder.[155] Remarkably, the IRS has taken the attitude that other nations must change their privacy laws to conform to the legal obligations of the FATCA legislation. In 2010, Doug Shulman, the U.S. Internal Revenue Service Commissioner, stated in a speech given to the Institute on Current Issues in International Taxation in Washington D.C., "Ideally, all countries with developed tax systems would come together to design a unified system for information reporting on their residents investing abroad. Until then, we will press on with our efforts to implement FATCA as required by law."[156]

Tax havens, from large developed countries to small developed dependencies, have used their privacy laws to attract foreign investment for years. Yet the Organization for Economic Co-operation and Development (OECD) has pushed to eliminate privacy of financial information over fifteen years and few countries will likely continue to not participate in these OECD efforts. If an intergovernmental agreement is reached among countries, then the concern for conflicts of law between the local jurisdictions and FATCA will be alleviated for FFIs located in those countries that participate. The model intergovernmental agreement that has been entered into by the United States and five European nations does avoid the legal problems in the field of data protection.

Chapter 15 and specific country chapters analyze the legal issues associated with privacy laws and customer data. Chapter 18 addresses the OECD's TRACE project for a unified tax information reporting system.

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[153] IRC § 1471(b)(1)(F)(i)(ii).

[154] Directive 95/46/EU of the European Parliament and the Council of 24, October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, *Official Journal of the European Communities*, No L 281/31, 23.11.95. Available at ec.europa.eu/justice/policies/privacy/docs/95-46-ce/dir1995-46_part1_en.pdf (accessed November 15, 2013).

[155] Directive 95/46/EU of the European Parliament and the Council of 24, October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data, *Official Journal of the European Communities,* No L 281/31, 23.11.95. Available at ec.europa.eu/justice/policies/privacy/docs/95-46-ce/dir1995-46_part1_en.pdf. Also see Jessica Meek, *supra*, 6–7.

[156] Jessica Meek, *supra*.

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[7] "Accidental American" Problem

[a] Defining Accidental American Status

Not every American citizen has familial, business, or personal ties to the U.S.[157] Certain persons are granted citizenship due to statutory constructs such as being born to a U.S. citizen. Others may have been born in the U.S., thereby attaining U.S. citizenship, but may since have moved to another location. These American citizens are subject to FATCA despite their lack of current ties to the U.S. Record numbers of them, over 3,000 projected for 2013, are expatriating as a result.[158]

In addition, persons who have previously held Legal Permanent Resident (LPR) status but have returned to their country of origin also are subject to FATCA. This category of persons for whom institutions must follow FATCA reporting but who have no real connections justifying the need for this have been called the "Accidental Americans" by various industry respondents such as the California State Bar.

[b] How FFIs Might React to the Accidental American

FFIs face two requirements. First, they must identify and monitor constantly for actual or putative American account holders, and, as a part of that requirement, must have all account holders provide W-9s to the FFI. Second, they must engage in new and significant "information reporting, tax withholding and payment, and filing of U.S. information returns."[159]

The Accidental American is subject to U.S. income tax on his or her worldwide income, and to information reporting requirements the same as a U.S. citizen or LPR residing in the U.S. FATCA will add another layer of complexity to treatment of the Accidental American, who in some foreign countries already experiences difficulty maintaining or opening bank accounts in their country of residence.[160]

FFIs are likely to find dealing with the Accidental American frustrating due to the extra layers of complexity. It will be important for FFIs to fully understand their obligations relating to the Accidental American. Some FFIs may even refuse to open new accounts for such persons because the FFI prefers not to deal with the compliance burden imposed by FATCA. A significant number of local FFIs may find it easier to comply with FATCA simply by terminating all U.S. Accounts, including Accidental American accounts, in order to avoid dealing with the most

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[157] Cal. Car Assn., Local FFIs and the Accidental American, http://bsmlegal.com/PDFs/CalBar.pdf.

[158] Saunders, Laura, "More Taxpayers Are Abandoning the U.S.", Wall Street Journal (November 13, 2013).

[159] Cal. Car Assn., Local FFIs and the Accidental American, http://bsmlegal.com/PDFs/CalBar.pdf.

[160] Cal. Car Assn., Local FFIs and the Accidental American, http://bsmlegal.com/PDFs/CalBar.pdf. Executive Summary, 1.

significant and risky compliance and conflict of laws problems.[161]

[c] Canada Expresses Concern over Dual-Citizenship American/Canadians

The Canadian government has expressed its opposition to terms of FATCA that affect dual-citizenship Canadian-Americans who reside in Canada. In a letter from the Canadian Minister of Finance, the Canadian government expressed concern about FATCA's "far-reaching extraterritorial implications, as it would turn Canadian banks into extensions of the IRS and would raise significant privacy concerns for Canadian citizens."[162] The Canadian Government has taken the following position: "The CRA does not and will not collect the tax liability of a Canadian citizen if the individual was a Canadian citizen at the time the liability arose (whether or not the individual was also a U.S. citizen at that time)."[163]

§ 1.19 COMPLIANCE COSTS

Time limitations for the implementation of FATCA regulations requires updated information reporting and withholding at the foreign and domestic financial institutions. A central problem centers on compiling and analyzing large amounts of customer data and creating new systems to resolve passthru payment issues. FATCA will be expensive for financial institutions to implement.

The website for Societé Générale Securities Services has a page entitled "FATCA FAQ." It notes that FATCA will require "huge implementation and processing costs and effort." An estimated cost of US$20-50 per account is not unrealistic. What is not discussed is the cost of liability insurance since FATCA requires that, among other matters, Compliance Officers will be personally liable. Government appears to have sovereign immunity. Considering that there is no FATCA computer system that is certified cyber secure, there is the potential for loss of private financial information by persons inside or outside of the financial institution. It is reasonable to expect that breaches of cyber security will bring litigation against the offending financial concerns that could include class action, derivative lawsuits, and even other regulatory enforcement actions where officers and directors may have personal liability exposures. At this time it is unknown what the cost of FATCA liability insurance will be as there is no historical date as to the frequency and severity of risks.

KPMG and Deloitte have estimated that FFIs will encounter high costs for compliance with FATCA. Their studies indicate that over 250,000 FFIs will be affected by FATCA. The affected institutions will include investment firms,

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[161] Cal. Car Assn., Local FFIs and the Accidental American, http://bsmlegal.com/PDFs/CalBar.pdf. Executive Summary, 3.

[162] Flaherty, James. Letter dated March 19, 2012, Minister of Finance of Canada, on FBAR and FATCA 2012FIN366699,.2.

[163] Flaherty, James. Letter dated March 19, 2012, Minister of Finance of Canada, on FBAR and FATCA 2012FIN366699,.2.

brokers, and banks among other financial institutions. The costs of FATCA range from hundreds of millions of dollars to billions.[164] Other studies suggest that the estimated implementation costs of FATCA can amount to upwards of $235 million per institution.[165] A representative of the Tax Department of BBVA, the second largest bank in Spain, stated in a conference held in Valencia (Spain) in October 2013 that compliance costs could range from EUR 8 million for a local entity to EUR 800 million for a global entity.[166] The recent cost estimate of the U.K. Revenue for U.K. financial institutions is a one-off cost, even considering the IGA, of approximately £900 million—£1,600 million, with an ongoing cost of £50 million–£90 million a year.[167]

Some observers have predicted that the cost of compliance for foreign institutions will greatly exceed the tax revenue the United States will collect. A problem in this context is the fact that the amount of monies from financial crimes that will be revealed cannot be determined. The IRS has claimed that over ten billion dollars in revenues will be recovered from offshore accounts over the next decade. The IRS has received $5.5 billion in revenue from its "Offshore Voluntary Disclosure" program that resulted from the UBS investigation. The Offshore Voluntary Disclosure program allowed U.S. taxpayers with hidden offshore accounts to disclose their assets and accounts and avoid criminal prosecution. It is an open issue as to whether many U.S. taxpayers continue to operate in noncompliance regarding reporting their foreign income.

Unremittingly, foreign financial institutions are having difficulty complying with FATCA. As commented on in an article in the New York Times, ". . . foreign banks and financial firms are increasingly finding that complying with the law is a major headache."[168] Certain FFIs are taking an alternative approach to compliance. Refusing to compile customer data and complying, the institutions are terminating accounts of U.S. persons. Deutsche Bank, Commerzbank, ING

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[164] Meek, Rebecca, "Banks Fear FATCA Raises Operational and Systemic Risks", *Operational Risk & Regulation*, September 26, 2011. Available at http://www.risk.net/operational-risk-and-regulation/feature/2109648/banks-fear-fatca-raises-operational-systemic-risks (last visited March 10, 2012).

[165] Meek, Rebecca, "Banks Fear FATCA Raises Operational and Systemic Risks", *Operational Risk & Regulation*, September 26, 2011. Available at http://www.risk.net/operational-risk-and-regulation/feature/2109648/banks-fear-fatca-raises-operational-systemic-risks (last visited March 10, 2012). See also: *Wall Street Journal*: "FATCA Creating a Compliance Gold Rush," Christopher M. Matthews, May 1, 2012, where estimates ranged "conservatively" at $250 million.

[166] International Congress on Exchange of Information, Tax Crimes and Money Laundering. Valencia, October 23–24, 2013. See http://www.tributacioninternacional.com/intercambio-de-informacion/ (accessed November 15, 2013).

[167] HMRC, Tax information and Impact Note—The International Tax Compliance (United States of America) Regulations 2013, August 7, 2013, http://www.hmrc.gov.uk/fatca/itc-regs-2013.pdf (accessed November 30, 2013).

[168] Browning, Lynnley, Complying With U.S. Tax Evasion Law Is Vexing Foreign Banks, New York Times (September 16, 2013).

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Group, Credit Suisse and HSBC have taken this position, terminating the investment accounts of U.S. persons and refusing to open new accounts.[169] These financial institutions cite the onerous regulations of the United States and contend that FATCA will make the problems worse.

The FATCA intergovernmental agreement will provide clarity for the financial services community that works with U.S. clients, taxpayers, and assets or any transaction cleared in the U.S. The breadth of FATCA and potential costs, burdens, and complications make clarity and certainty important from an economics perspective. The one burden imposed on other governments concluding a Joint Statement and Intergovernmental Agreement with the U.S. is that it does require them to receive the FATCA reports and forward them to the U.S. There would be additional cost and human resource burden on the tax authority of the FATCA partner.[170]

Financial institutions, other businesses and individuals are paying the fees for their lawyers, accountants, consultants and service providers who see the huge sums of money associated with FATCA "as a gold mine for compliance professionals."[171] Obviously, this potentially could result in a conflict of interest. There is no doubt that the U.S. Treasury is pressing forward with FATCA implementation, but the success of that effort, as with the ACA (Obamacare) is certainly not free from doubt. Besides the question of how to comply, other relevant questions may need to be considered first.

§ 1.20 LACK OF EXECUTED IGAs WILL CAUSE FATCA TO FAIL

It almost goes without saying that if the United States cannot obtain the acceptance of FATCA by nearly every country of the world, then FATCA will go onto the dust bin of history as another example of failed government policy. Although FATCA as passed was unilateral in application, that is the U.S. imposed it on everyone else but not itself, the U.S. Treasury subsequently was forced to develop a reciprocal model International Government Agreement (IGA). These reciprocal IGAs would bind the U.S. to provide equivalent levels of reciprocal

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[169] "Europas Banken verjagen US-Kunden". *Financial Times Deutschland*. December 14, 2011. Available at http://www.ftd.de/unternehmen/finanzdienstleister/:verwaltungsaufwand-europas-banken-verjagen-us-kunden/60142278.html (last visited December 31, 2012). "European Banks Stop Serving American Customers". *Der Spiegel*. December 14, 2011. Available at http://www.spiegel.de/international/business/reaction-to-us-tax-law-european-banks-stop-serving-american-customers-a-803742.html (last visited December 31, 2012). "German banks abandon US customers". *The Local*. December 15, 2011. Available at http://www.thelocal.de/money/20111215-39519.html (last visited December 31, 2012).

[170] Zagaris, Bruce. *Zagaris on FATCA: World expert gives detailed look at compliance and enforcement under the landmark law*. Available at http://www.financialcrimeconference.com/zagaris-on-fatca-world-expert-gives-detailed-look-at-compliance-and-enforcement-under-the-landmark-law/.

[171] WSI, FATCA Creating a Compliance Gold Rush, Christopher Mathews, May 1, 2012.

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automatic exchange to foreign FATCA partners.[172]

Some major players are balking at entering into a FATCA IGA without having a truly reciprocal agreement.[173] Although Treasury has claimed it has authority to enter into reciprocal IGAs, that is in dispute with some members of Congress. Congressman Bill Posey, an influential member of the House Financial Services Committee has sent a letter to Treasury Secretary Lew[174] regarding change of regulations to require U.S. banks to report on interest paid to nonresident aliens. He notes the FATCA IGA with the U.K. which indicates an agreement for reciprocity and the provision for authority for Treasury as published in the President's FY2014 Budget, page 202. As Rep. Posey states, "I further note that the IGAs that are being entered into are not authorized, or even mentioned in FATCA." He goes on to state, "It is clear that FATCA must be either substantially amended or repealed, and replaced with a cooperative scheme that penalizes actual tax evasion without harming the innocent." He introduced bipartisan legislation in the House as H.R. 2299 to repeal FATCA. Some commentators also question the legal nature of the IGAs: while in the U.S. an IGA is just an internal provision, in the rest of the countries is an international treaty. There is no provision in the Vienna Convention on the Law of the Treaties similar to FATCA-IGAs.[175]

Senator Rand Paul introduced legislation in the Senate as 5.887 to repeal FATCA. Senators Rand Paul, Mike Lee, Jim Demint and Saxby Chambliss sent a five page letter dated July 25, 2012 to then Treasury Secretary Geithner regarding FATCA with critical questions to be answered in 30 days. Former Secretary Geithner did not reply and, to date, neither has the recently appointed Secretary Lew.

§ 1.21 FATCA MAY OPEN FIs DOORS TO SECURITY AGENCIES

Internal Revenue code section 6103 allows the U.S. government agencies, including intelligence agencies and even Congress, to effectively gain access to information obtained through FATCA. Section 6103 permits disclosure of return information to certain federal officers, employees, and law enforcement agencies for purposes of combating terrorism. Thus, FATCA may become another avenue

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[172] Bloomberg Law, Full Reciprocity Under FATCA is a Work in Progress, Andrew M. Ballard.

[173] Risk.net, France and Germany seeking greater FATCA reciprocity before signing IGAs, Jessica Mark.

[174] Letter from Bill Posey to Secretary Jack Lew, July 1, 2013.

[175] Alfredo García Prats, International Congress on Exchange of Information, Tax Crimes and Money Laundering. Valencia, October 23-24, 2013. See http://www.tributacioninternacional.com/intercambio-de-informacion/ (accessed November 15, 2013). Prof. García Prats also stated that the 30 per cent withholding constitutes a treaty override and that FATCA is a "global agreed unilateral request of information", which could be theoretically considered as a "fishing expedition", contrary to Article 27 of the Spain-U.S. DTA, but also contrary to the non-discrimination clause of Article 25 of the said DTA.

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for gathering information for the NSA.[176]

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[176] Reason.com, How IRS Can Share Your Bank Info with Security Agencies, July 26, 2013. See also Menn, Joseph, U.S. Power to Shape Global Web Seen Undermined by NSA Spying, Reuters (November 5, 2013).

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