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I Got 99 Problems and They're All FATCA

Nirav (Jonathan) Dhanawade

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I Got 99 Problems and They're All FATCA

*By Nirav (Jonathan) Dhanawade**

Abstract: Offshore personal income tax evasion accounts for approximately \$50 billion in annual lost revenue for the United States. These large sums of money are squirreled away in tax havens—jurisdictions, such as Aruba, the Cayman Islands, and Dubai, whose laws allow some U.S. citizens to evade paying their U.S. income taxes. Before the Foreign Account Tax Compliance Act (FATCA) was enacted, U.S. citizens could avoid taxes on passive income by not reporting this income to the Internal Revenue Service (IRS). To detect tax evasion, the IRS pursued U.S. citizens with undeclared assets in foreign banks. But the IRS's quest was largely unsuccessful because foreign financial institutions did not fully report U.S. account holders' information. While the IRS occasionally discovered offshore accounts, U.S. taxpayers were largely on the "honor system." Unfortunately, many U.S. taxpayers with offshore accounts have been dishonest. As a result, Congress brought the hammer down with FATCA to combat and, more importantly, prevent tax evasion. This Comment discusses FATCA's provisions, particularly those that have been heavily criticized. It then explores these criticisms from a domestic and foreign perspective. In doing so, this Comment examines and endorses Intergovernmental Agreements (IGAs) as (1) a solution to FATCA's shortcomings and (2) a building block for developing a sustainable model of international tax transparency and information reporting. Finally, this Comment argues that the United States should continue working with the Organisation for Economic Co-operation and Development towards the adoption of a multilateral automatic information exchange standard that will enhance tax transparency and reduce tax evasion at an international level.

* J.D., 2015, Northwestern University School of Law; B.A., 2011, University of Delaware. Every one of my accomplishments is attributable to the grace of God and the kindness of others. This Comment is no different. I thank David Miller for his keen insight and advice, and my colleagues at the *Northwestern Journal of International Law & Business* for their thoughtful input and time. This Comment is as much theirs as it is mine. I also owe a great deal of gratitude to my wife, Maja, for coming up with the title of this Comment and for her unwavering support in all of my endeavors.

TABLE OF CONTENTS

I. Introduction	141
II. Keep It Simple, Stupid: FATCA Delineated.....	143
A. The People Problem: § 6038D.....	143
1. Big Brother is Watching: Required Information Reporting	144
2. Few Carrots, Mostly Sticks: Penalties Under § 6038D	144
B. FFIs and Non-FFIs: §§ 1471 and 1472.....	145
1. How to Spot an FFI	145
2. Demystifying “Withholdable Payments”.....	146
3. FFIs’ Guide to Avoiding the Withholding Tax.....	146
4. Distinguishing FATCA Withholding from Chapter 3 Withholding.....	147
III. Reading the Comment Box: What’s Wrong with FATCA?	148
A. The Overseas Outcry	148
B. The Tax Treaty Veto.....	149
C. Shhh! Bank Secrecy Concerns.....	149
D. More Money, More (Local) Problems.....	150
E. More Money, More (Foreign) Problems.....	151
F. Complexity, Confusion, Calamity?	152
IV. Lessons from Overseas: The Global Forum’s Approach	152
A. Not Just Another Useless International Organization.....	152
1. The Emergence of International Tax Standards.....	153
2. Membership.....	153
B. Examining the Playbook: Keys to Success.....	154
1. Coordination.....	154
2. Balance	154
3. Multilateral Tax Treaties	155
V. The Blueprint: IGAs.....	156
A. Fundamentally Flawed: The B2G Approach	156
B. Let Us Take a Moment and Give Thanks	157
C. There is Another Way.....	158
1. IGAs for Dummies	158
2. Apples to Apples?: Comparing Model 1 and Model 2 IGAs.....	160
a. Due Diligence	160
b. Information Reporting	161
c. Withholding	161
d. Enforcement.....	162
3. Survey Says: OECD Agrees!	162
VI. Putting It All Together	164

I. INTRODUCTION

A Swiss banker met his U.S. client in a remote-controlled elevator where bank statements, tucked within a *Sports Illustrated* magazine, exchanged hands.¹ Another Swiss banker hauled bags of cash across the United States to help his U.S. clients avoid taxes.² Both men worked for Credit Suisse AG, the target of a U.S. Department of Justice investigation that is expected to end in a settlement exceeding \$780 million.³ Fourteen other banks, including rival UBS AG, are also being probed for helping U.S. citizens evade taxes through secret overseas accounts.⁴ One of these U.S. citizens—Beanie Babies creator and billionaire, H. Ty Warner—hid \$25 million in overseas accounts.⁵ Standing before a federal judge in Chicago, the sixty-nine-year-old businessman tearfully admitted that he evaded \$5 million in taxes.⁶

At first glance, U.S. tax evasion seems like a trivial problem, especially in comparison to ostensibly more pressing issues facing Americans, including obesity,⁷ poor health care,⁸ and, of course, reality-television-induced brain drain.⁹ But believe it or not, U.S. tax evasion has earned its place on the wall of shame. Offshore personal income tax evasion accounts for around \$50 billion in annual lost revenue for the United States.¹⁰ These large sums of money are squirreled away in tax

¹ Andrew Grossman, John Letzing & Laura Saunders, *Ex-Banker's Plea Deal Outlines Trail of a Tax-Evasion Scheme*, WALL ST. J. (Mar. 12, 2014, 7:33 PM), <http://online.wsj.com/news/articles/SB10001424052702304914904579435090290201078?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2F%2FSB10001424052%20702304914904579435090290201078.html>.

² *Id.*

³ *Id.*

⁴ Susannah Nesmith & David Voreacos, *Ex-UBS Banker Lack Pleads Guilty in U.S. Tax Case*, BLOOMBERG (Feb. 26, 2014, 2:27 PM), <http://www.bloomberg.com/news/2014-02-26/ex-ubs-banker-lack-pleads-guilty-in-u-s-tax-case.html>.

⁵ *Beanie Babies Creator Pleads Guilty to Tax Evasion*, NBC NEWS (Oct. 2, 2013, 3:28 PM), <http://www.nbcnews.com/business/beanie-babies-creator-pleads-guilty-tax-evasion-8C11323460>.

⁶ *Id.*

⁷ See *Overweight and Obesity*, CTR. FOR DISEASE CONTROL & PREVENTION, <http://www.cdc.gov/obesity/data/facts.html> (last updated Sept. 3, 2014) (discussing the “dramatic rise in obesity” in the United States).

⁸ See, e.g., *The Shame of American Health Care*, N.Y. TIMES (Nov. 17, 2013), http://www.nytimes.com/2013/11/18/opinion/the-shame-of-american-health-care.html?_r=0 (“[B]y virtually all measures of cost, access to care and ease of dealing with insurance problems, Americans fared poorly compared with people in other advanced countries.”).

⁹ See, e.g., Melissa Dahl, *Watching ‘Jersey Shore’ Might Make You Dumber, Study Suggests*, NBC NEWS (Jun. 17, 2011, 6:20 AM), http://bodyodd.nbcnews.com/_news/2011/06/17/6851542-watching-jersey-shore-might-make-you-dumber-study-suggests?lite (discussing media priming: the “idea that the things we watch or listen to or read influence[s] our emotions and our behavior”).

¹⁰ Frederic Behrens, Comment, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 WIS. L. REV. 205, 207 (2013) (citing Steven A. Dean, *More Cooperation, Less Uniformity: Tax*

havens—jurisdictions, such as Aruba, the Cayman Islands, and Dubai, whose laws allow some U.S. citizens to evade paying their U.S. income taxes.¹¹ Before the Foreign Account Tax Compliance Act (FATCA)¹² was enacted, U.S. citizens could avoid taxes on passive income, including interest, dividends, and capital gains, by not reporting this income to the Internal Revenue Service (IRS).¹³

To detect tax evasion, the IRS pursued U.S. citizens with undeclared assets in foreign banks.¹⁴ But its quest was largely unsuccessful¹⁵ because foreign financial institutions (FFIs) did not fully report U.S. account holders' information.¹⁶ While the IRS occasionally discovered offshore accounts, U.S. taxpayers were largely on the "honor system."¹⁷ Unfortunately, many U.S. taxpayers with offshore accounts have been dishonest.¹⁸ As a result, Congress brought the hammer down with FATCA to combat and, more importantly, prevent tax evasion.¹⁹

This Comment argues that the United States should continue working with the Organisation for Economic Co-operation and Development (OECD) towards the adoption of a multilateral automatic information exchange standard that will enhance tax transparency and reduce tax evasion at an international level. This Comment proceeds as follows: Part II discusses FATCA's provisions, particularly those that have been heavily criticized. Part III explores these criticisms from a domestic and foreign perspective. In Part IV, this Comment reviews the tax transparency and information exchange standards proposed by the Global Forum on Tax Transparency and Exchange of Information for Tax Purposes (Global Forum). Finally, Part V utilizes these standards to examine and endorse Intergovernmental Agreements (IGAs) as (1) a solution to FATCA's shortcomings and (2) a building block for developing a sustainable model of international tax transparency and information reporting.

Deharmonization and the Future of the International Tax Regime, 84 TUL. L. REV. 125, 132 (2009)).

¹¹ *Id.* at 206.

¹² FATCA is a federal law aimed at reducing tax evasion by U.S. taxpayers with offshore accounts. See *infra* Part II.

¹³ Behrens, *supra* note 10, at 206–07.

¹⁴ *Id.* at 207.

¹⁵ J. Richard (Dick) Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and Its Potential Future*, 57 VILL. L. REV. 471, 473 (2012).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ See Melissa A. Dizdarevic, Comment, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 FORDHAM L. REV. 2967, 2968–69 (2011).

II. KEEP IT SIMPLE, STUPID: FATCA DELINEATED

Congress's primary goal in passing FATCA was to prevent tax evasion by U.S. taxpayers with offshore accounts.²⁰ Specifically, FATCA was designed to address the "deliberate and illegal hiding of assets and income from the IRS by U.S. citizens and residents."²¹ Legislation was introduced in October 2009²² and modified in December 2009²³ before FATCA was finally adopted as part of the Hiring Incentives to Restore Employment Act in March 2010.²⁴

FATCA's approach is two-pronged with one prong addressing individual taxpayers and the other prong addressing FFIs.²⁵ The following sections explore FATCA's dual-pronged approach.

A. The People Problem: § 6038D

FATCA enacted § 6038D, which requires individuals holding "any interest in a specified foreign financial asset" to disclose these assets in their Form 1040 if the assets' aggregate value exceeds \$50,000 during "any taxable year."²⁶ This reporting requirement took effect with 2011 income tax returns.²⁷ Section 6038D(b) defines a "specified foreign financial asset" as follows:

- (1) any financial account . . . maintained by [an FFI] . . . , and
- (2) any of the following assets which are not held in an account maintained by a financial institution . . .
 - (A) any stock or security issued by a person other than a United States person,

²⁰ See *Foreign Account Tax Compliance Act (FATCA)*, U.S. DEP'T OF THE TREAS., <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> (last updated June 9, 2014) ("FATCA was enacted in 2010 by Congress to target non-compliance by U.S. taxpayers using foreign accounts.").

²¹ *Foreign Bank Account Reporting and Tax Compliance: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 111th Cong. 13 (2009) [hereinafter *Hearing*] (statement of William J. Wilkins, Chief Counsel, Internal Revenue Service).

²² Foreign Account Tax Compliance Act of 2009, H.R. 3933, 111th Cong. (2009).

²³ H.R. 4213, 111th Cong. (2010).

²⁴ Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, §§ 501-535, 124 Stat. 71, 97-115 (2010).

²⁵ *Id.*

²⁶ I.R.C. § 6038D (2010).

²⁷ *Id.*

(B) any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and

(C) any interest in a foreign entity.²⁸

Under § 6038D(h)(1), the IRS can also create exceptions to these reporting requirements to avoid duplicative disclosures.²⁹

1. Big Brother is Watching: Required Information Reporting

Section 6038D(c) specifies the following foreign asset information that U.S. taxpayers must disclose: (1) the name and final address of the FFI where assets are maintained, including the number of the account; (2) for stocks or securities, “the name and address of the issuer” and any other relevant information necessary to identify the stock or security’s class or issue; (3) for instruments, contracts, or interests, “such information as is necessary to identify such instrument[s], contract[s], or interest[s]” and “the names and addresses of all issuers and counterparties”; and (4) the assets’ maximum values during the taxable year.³⁰

2. Few Carrots, Mostly Sticks: Penalties Under § 6038D

If individual taxpayers fail to disclose the foreign asset information required under § 6038D(c), FATCA penalizes them \$10,000.³¹ If a taxpayer still fails to disclose this information for more than ninety days after notification by the IRS, the taxpayer is levied an additional penalty of \$10,000 for each thirty-day period or fraction thereof.³²

FATCA attempts to balance this “stick” with a “carrot.” Section 6038D(g) permits a waiver of the penalties described above if the failure to disclose required foreign asset information was due to “reasonable cause and not due to willful neglect.”³³ Still, this carrot is tempered by the

²⁸ *Id.*

²⁹ *Id.* § 6038D(h)(1); *see also* Alan S. Lederman & Bobbe Hirsh, *The American Assault on Tax Havens-Status Report*, 44 INT’L LAW. 1141, 1142 (2010) (stating that the IRS can create exceptions to “passive foreign investment company (PFIC) and controlled foreign corporation stockownership reporting”).

³⁰ I.R.C. § 6038D(c) (2010).

³¹ *Id.* § 6038D(d)(1).

³² *Id.* § 6038D(d)(2). But any additional penalties imposed under § 6038D(d)(2) cannot exceed \$50,000. *Id.*

³³ *Id.* § 6038D(g).

provision that foreign secrecy laws do not constitute “reasonable cause.”³⁴ Additionally, the \$50,000 threshold for mandatory disclosures is considered met (1) if the IRS discovers specified foreign financial assets, and (2) if the taxpayer fails to provide sufficient information indicating that the total value of these assets does not exceed \$50,000.³⁵

FATCA also imposes a stiff 40% penalty on financial understatements of undisclosed financial assets.³⁶ Notably, understatements of financial statements exceeding \$5,000 are still fair game even if the existing three-year statute of limitations has run because § 6501 permits for its extension under these circumstances.³⁷ With FATCA’s approach to addressing individual taxpayers as a backdrop, the following section examines FATCA’s approach to FFIs.

B. FFIs and Non-FFIs: §§ 1471 and 1472

FATCA’s second prong addresses FFIs.³⁸ Specifically, FATCA imposes a 30% tax on “withholdable payments” to FFIs that meet § 1471’s criteria.³⁹ FATCA also imposes a 30% tax on withholdable payments to certain foreign entities that are not FFIs (non-FFIs).⁴⁰ The following subsections (1) define FFIs and “withholdable payments,” (2) discuss the 30% withholdable tax, and (3) distinguish FATCA’s tax withholding system from another tax withholding system that the United States already employs.

1. How to Spot an FFI

Section 1471(d)(4) defines an FFI as “any financial institution which is a foreign entity,” not including financial institutions organized “under the laws of any possession of the United States.”⁴¹ Thus, FFIs are defined

³⁴ *Id.*

³⁵ *Id.* § 6038D(e).

³⁶ See *The Section 6662(e) Substantial and Gross Valuation Misstatement Penalty*, IRS, http://www.irs.gov/pub/irs-apa/penalties6662_e.pdf (last visited Mar. 24, 2014).

³⁷ I.R.C. § 6501(e)(1)(A) (2010).

³⁸ See *id.* §§ 1471, 1472.

³⁹ See *id.* § 1471(a). The withholding tax does not apply to FFIs that enter into an FFI Agreement with the IRS. But FFIs must deduct 30% of any passthru payment to either a recalcitrant account holder or other FFI that has not entered into an FFI Agreement. *Id.* § 1471(b)(1)(D).

⁴⁰ *Id.* § 1472.

⁴¹ *Id.* § 1471. Section 1471(d)(5) defines “financial institution” as any entity that does one of the following:

- (A) accepts deposits in the ordinary course of a banking or similar business,
- (B) as a substantial portion of its business, holds financial assets for the account of others,

broadly to include foreign banks, trust companies, brokerage firms, mutual funds, hedge funds, and private equity funds.⁴²

2. *Demystifying “Withholdable Payments”*

Congress through § 1473 defined “withholdable payments” as the following:

- (i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and
- (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.⁴³

Section 1473 also defines “withholding agent” as “all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment.”⁴⁴ Thus, income that would otherwise be exempt from taxation under the Internal Revenue Code may now be subject to FFI withholding under FATCA unless an FFI enters into an FFI Agreement.⁴⁵

3. *FFIs’ Guide to Avoiding the Withholding Tax*

While a 30% withholding tax might seem harsh, FATCA provides FFIs with a way to avoid the tax—compliance.⁴⁶ Specifically, § 1471(b) provides that FFIs can avoid the 30% withholding tax by taking the following steps: (1) identifying their U.S. accounts; (2) complying with due diligence and verification procedures regarding possible U.S. accounts;

or
(C) is engaged . . . primarily in the business of investing, reinvesting, or trading in securities . . . , partnership interests, commodities . . . , or any interest . . . in such securities, partnership interests, or commodities.

Id.

⁴² Lederman & Hirsh, *supra* note 29, at 1143.

⁴³ I.R.C. § 1473 (2010).

⁴⁴ *Id.* § 1473(4).

⁴⁵ Lederman & Hirsh, *supra* note 29, at 1144 (stating that withholdable payments encompass capital gains, portfolio interest, bank deposit interest, and recovery costs of U.S. stocks and bonds).

⁴⁶ *See* I.R.C. § 1471(b) (2010).

(3) annually reporting information about these U.S. accounts to the IRS; (4) withholding the 30% FATCA tax, or be withheld upon, on passthru payments to other FFIs that did not enter into FFI agreements with the IRS, or on payments to recalcitrant account holders who fail to supply information regarding U.S. account ownership; (5) complying with any IRS requests for additional information about U.S. accounts; and (6) if foreign law prevents disclosure, seeking a waiver of the law or closing the account in question if a waiver cannot be obtained.⁴⁷

Under § 1471(b)(2)(A), an FFI can also avoid the 30% withholding tax if (1) the FFI complies with IRS procedures ensuring that it does not maintain U.S. accounts and meets requirements prescribed by the IRS regarding other FFIs' accounts, (2) the FFI is a "member of a class of institutions" for which the IRS creates an exception,⁴⁸ or (3) the FFI does not invest in U.S. assets.⁴⁹

Having described FATCA's provisions, the following subsection now distinguishes FATCA's withholding system from that of its predecessor.

4. Distinguishing FATCA Withholding from Chapter 3 Withholding

Prior to FATCA's enactment, the United States already employed a tax withholding system under Chapter 3 of the Internal Revenue Code.⁵⁰ Under Chapter 3, a withholding agent must withhold 30% of any U.S.-source payment, including fixed, determinable annual, or periodical (FDAP) income made to foreign persons.⁵¹ But unlike FATCA's tax withholding system, which applies to all U.S.-source payments to FFIs and certain Non-Financial Foreign Entities,⁵² Chapter 3 withholding only applies to payments to nonresident aliens and foreign corporations.⁵³

FATCA also imposes a withholding tax on gross proceeds from the sale or disposition of income-producing property from a U.S. source, and FDAP income.⁵⁴ FATCA withholding is therefore fundamentally different from Chapter 3 withholding, but collectively, these mechanisms produce a more robust withholding structure than previously existed.

⁴⁷ *Id.*

⁴⁸ *Id.* ("[S]uch institution is a member of a class of institutions [that] . . . the Secretary has determined that the application of this section is not necessary to carry out the purposes of this section.").

⁴⁹ *See id.* § 1473(1).

⁵⁰ *See id.* § 1441.

⁵¹ *Id.*

⁵² *See id.* § 1472.

⁵³ *See id.* §§ 1441–1442.

⁵⁴ *Id.* § 1473(1)(A)(ii); *see also id.* § 1441(b).

III. READING THE COMMENT BOX: WHAT'S WRONG WITH FATCA?

Despite the United States' legitimate need to detect and deter offshore personal income tax evasion, FATCA's passage was commemorated with much gnashing of teeth—a sentiment that continues to grow.⁵⁵ The following sections explore the complaints of U.S. banks and U.S. citizens living abroad, as well as foreign countries and their financial institutions.

A. The Overseas Outcry

To avoid complying with FATCA's disclosure requirements, some FFIs are severing ties with their U.S. account holders.⁵⁶ These FFIs cite the costs of compliance as the reason for their decision.⁵⁷ Consequently, some U.S. citizens living abroad criticize FATCA for making it difficult for them to establish and maintain foreign bank accounts.⁵⁸

Alarming, even more U.S. citizens living abroad could face account closures if their foreign banks cannot comply with FATCA's disclosure requirements.⁵⁹ This is likely to happen when a bank is not large enough to comply, but is simultaneously too large to altogether avoid U.S. investments.⁶⁰ As a result, these U.S. citizens may be limited to opening and maintaining accounts with smaller foreign banks that do not hold any U.S. portfolios.⁶¹ Certain critics, including Marylouise Serrato and Jacqueline Bugnion of American Citizens Abroad,⁶² predict that eventual FATCA exclusions might also cause these U.S. citizens to have difficulty purchasing foreign insurance policies and pension funds.⁶³

Therefore, for some U.S. citizens living abroad, the burden of complying with FATCA's individual reporting requirements trumps the

⁵⁵ See, e.g., *Hearing*, *supra* note 21, at 7.

⁵⁶ Joanna Heiberg, *FATCA: Toward A Multilateral Automatic Information Reporting Regime*, 69 WASH. & LEE L. REV. 1685, 1702 (2012).

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ Lederman & Hirsh, *supra* note 29, at 1147.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² American Citizens Abroad is an organization that claims to represent the interests of U.S. citizens residing overseas. See *FAQ about ACA, Inc.*, AM. CITIZENS ABROAD, <https://americansabroad.org/about/faq-about-aca-inc/> (last updated Oct. 10, 2013).

⁶³ Lederman & Hirsh, *supra* note 29, at 1147. FFIs might altogether refuse to deal with U.S. citizens living abroad. Olga Basko, *FATCA: Taxes Just Got More Complicated*, COL. BUS. L. REV. ONLINE (Dec. 3, 2013, 12:04 PM), <http://cblr.columbia.edu/archives/12917>.

advantages of U.S. citizenship.⁶⁴ But the U.S. Department of State does not let these patriots off the hook easily—renunciation comes with a \$450 price tag.⁶⁵ Former U.S. citizens are also not relieved of their existing tax liabilities and penalties owed.⁶⁶ Moreover, Uncle Sam levies a special “exit tax” on the soon-to-be-former U.S. citizens with a net worth of at least \$2 million, or an annual income of about \$150,000.⁶⁷ So while renunciation allows U.S. citizens living abroad to avoid FATCA’s reporting requirements, it comes at a considerable price.

B. The Tax Treaty Veto

A second criticism of FATCA is that it effectively constitutes a tax-treaty veto by overriding contradictory provisions in existing income-tax treaties.⁶⁸ FATCA’s information reporting requirements are more demanding than those of existing tax treaties.⁶⁹ And as discussed above, FATCA imposes a 30% withholding tax on noncompliant FFIs regardless of their withholding rates under existing tax treaties.⁷⁰ Under some tax treaties, certain taxpayers can obtain reduced withholding rates through a refund mechanism.⁷¹ But courtesy of FATCA, these preferential withholding rates do not apply when an FFI is a payee.⁷²

C. Shhh! Bank Secrecy Concerns

FATCA also creates concerns in the realm of local bank-secrecy laws because many foreign countries do not allow their banks or financial institutions to divulge clients’ information to other governments.⁷³

⁶⁴ Heiberg, *supra* note 56, at 1702.

⁶⁵ *Id.* at 1703.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *See id.*; *see also id.* at 7, 62 (“Treaty overrides adversely affect the treaty-making process and historically have been avoided unless essential to the ends sought by the legislation.”).

⁶⁹ *Id.* at 1703.

⁷⁰ *Id.* (discussing how FATCA’s provisions override those of governing tax treaties).

⁷¹ *Id.* For examples of existing tax refund mechanisms, see I.R.C. § 1445(c)(1)(C) (2012). “Economic double taxation” occurs when two or more countries tax an individual or entity on the same income. To avoid economic double taxation, domestic tax laws can (1) employ the credit method by providing credit against domestic taxes for foreign taxes paid on the same income or (2) exempt the income from domestic taxation. *Internal Revenue Manual – 4.60.3 Tax Treaty Related Matters*, IRS, http://www.irs.gov/irm/part4/irm_04-060-003.html (last visited Oct. 22, 2014).

⁷² Heiberg, *supra* note 56, at 1703–04.

⁷³ *See, e.g.*, David Jolly & Brian Knowlton, *Law to Find Tax Evaders Denounced*, N.Y. TIMES, Dec. 27, 2011, at B1 (quoting Jeffrey Owens, tax expert at the Organisation for Economic Co-operation and Development) (“Enforcement of the law will be tricky, as many countries . . . forbid banks or companies

Moreover, FATCA requires FFIs and foreign banks to deny accounts to U.S. citizens if they cannot comply with its reporting requirements.⁷⁴

But for some FFIs, simply avoiding U.S. assets may not be enough because, under FATCA's passthru reporting requirement, certain non-U.S. income is subject to required reporting if the income is attributable to a withholdable payment.⁷⁵ Some critics argue that the passthru provision forces foreign banks to ensure that all of their non-U.S. funds comply with FATCA's reporting requirement.⁷⁶ One of these critics, the British Bankers' Association (BBA), labeled the passthru payment "simply unworkable."⁷⁷ Cue Intergovernmental Agreements (IGAs).

D. More Money, More (Local) Problems

Within FATCA's framework, IGAs involve FFIs reporting U.S. account holders' information to their respective national tax authorities that, in turn, provide this information to the United States.⁷⁸ Under existing non-FATCA IGAs, U.S. banks already provide substantial information to foreign governments.⁷⁹ The IGA approach, discussed in greater detail in Part V of this Comment, circumvents the legal impediments that FATCA poses.⁸⁰ IGAs also reduce FFIs' burden of compliance by allowing them to report U.S.-account information through their respective national governments.⁸¹ The IGA approach is therefore the solution to the previously referenced criticism by the BBA.⁸²

Under FATCA, U.S. banks will need to develop and maintain systems tying account holders' nationalities to their respective accounts.⁸³ FATCA's critics argue that this is currently unfeasible given the lack of

to transfer such information directly to a foreign government."). Countries such as Switzerland are popular destinations for U.S. citizens looking to set up a "nest egg" overseas. *See, e.g.*, Mark Nestmann, *Despite Tightening of U.S. Laws, Switzerland Remains a Safe Haven for Money*, HEARTLAND INST. (Aug. 5, 2014), <http://news.heartland.org/newspaper-article/2014/08/05/despite-united-states-laws-switzerland-still-safe-haven-money>.

⁷⁴ Behrens, *supra* note 10, at 222.

⁷⁵ *See* I.R.C. § 1471 (2010). Regulations have delayed withholding passthru payments until 2017 at the earliest. *See generally* IRS, NOTICE 2013-43, REVISED TIMELINE AND OTHER GUIDANCE REGARDING THE IMPLEMENTATION OF FATCA (2013), *available at* <http://www.irs.gov/pub/irs-drop/n-13-43.pdf>.

⁷⁶ Behrens, *supra* note 10, at 221.

⁷⁷ *Id.*

⁷⁸ *FATCA Key Terms*, THOMSON REUTERS, <http://fatca.thomsonreuters.com/about-fatca/key-terms/> (last visited Oct. 1, 2014).

⁷⁹ *See* Behrens, *supra* note 10, at 222.

⁸⁰ *See id.* at 215.

⁸¹ *Id.*

⁸² *See id.* at 221.

⁸³ *Id.* at 222.

existing regulations directing U.S. banks.⁸⁴ This is, however, an exaggerated claim because existing antiterrorism and money laundering laws currently place U.S. banks in a better position than ever before to implement FATCA's measures.⁸⁵ A related criticism, that FATCA's compliance measures will raise the cost of domestic banking services for retail U.S. customers, is at best unclear.⁸⁶

E. More Money, More (Foreign) Problems

Yet another criticism of FATCA is that its requirements place a high financial burden on FFIs.⁸⁷ For example, the Institute of International Bankers (the Institute) predicts that compliance with FATCA might cost international banks over \$250 million.⁸⁸ Other foreign businesses predict that annual compliance costs might actually be billions of dollars.⁸⁹ But these numbers are mere predictions.⁹⁰ For example, in reaching the aforementioned \$250 million figure, the Institute stated that "several large institutions" estimated on a "conservative basis" that they would incur an average cost of \$10 per account to properly identify and document customers' accounts.⁹¹ The Institute did not specify (1) which institutions made the \$10-an-account prediction, (2) why this prediction is accurate, and (3) how this prediction is "conservative."⁹² So while the Institute has thrown around some big numbers, none of them are currently verifiable.

⁸⁴ *Id.*

⁸⁵ See generally 31 U.S.C. § 5318A (2010); Uniting and Strengthening America by Providing Appropriate Tools Required To Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, Pub. L. No. 107-56, 115 Stat 272 (2001).

⁸⁶ Behrens, *supra* note 10, at 222. Because FATCA has yet to be fully implemented, speculation about U.S. banks shifting their increased costs of compliance on to retail U.S. consumers is just that—speculation. Nonetheless, as Behrens correctly states, U.S. banks are currently in a better position than ever before to implement FATCA's compliance measures because of antiterrorism and money laundering laws currently in force. Thus, the additional cost of FATCA-specific compliance remains unclear. Similarly, the degree to which this compliance will affect U.S. retail consumers is equally unclear. See *id.*

⁸⁷ Heiberg, *supra* note 56, at 1704.

⁸⁸ *Id.* at 1704–05.

⁸⁹ *Id.* at 1705.

⁹⁰ See EUR. BANKING FED'N & INST. OF INT'L BANKERS, COMMENTS ON NOTICE 2010-60 PROVIDING PRELIMINARY GUIDANCE ON FATCA (Nov. 12, 2010), available at <http://www.cticompliance.com/assets/pdf/EBF-IIB%202010%2011%2012.pdf> ("Our members are still attempting to quantify the *potential* cost [of FATCA]... preliminary indications are that costs will be staggering.") (emphasis added).

⁹¹ *Id.*

⁹² See generally *id.*

Relatedly, critics assert that FATCA might cause some FFIs to altogether avoid investing in the United States.⁹³ This, in turn, might discourage future U.S. investments by other FFIs, or it might shift the costs of compliance on to American investors.⁹⁴ But, as with the Institute's \$10-an-account prediction, it is still too early to verify or discredit this criticism.

F. Complexity, Confusion, Calamity?

Lastly, critics, including the Taxpayer Advocate Service (TAS),⁹⁵ bash FATCA for worsening an already complex and confusing system of international taxation.⁹⁶ According to these critics, the IRS should focus on taxpayer services, not international law enforcement.⁹⁷ But they seem to have forgotten that it was Congress, the most representative branch of the U.S. government,⁹⁸ and not the IRS, that passed FATCA.⁹⁹ Thus, the IRS does not have any choice but to enforce FATCA. A more logical complaint might be the lack of clear guidance provided to the IRS by Congress, but alas, FATCA bashing is the TAS's province.

IV. LESSONS FROM OVERSEAS: THE GLOBAL FORUM'S APPROACH

The preceding sections described FATCA's origin, design, and defects. The following section discusses the Global Forum and explains the tax transparency and information exchange standards that it has proposed. These standards are then used to propose modifications to FATCA's approach.

A. Not Just Another Useless International Organization

The Global Forum is the continuation of a forum created by the OECD to address tax compliance issues caused by tax havens.¹⁰⁰ It originally

⁹³ Heiberg, *supra* note 56, at 1705.

⁹⁴ *Id.*

⁹⁵ The Taxpayer Advocate Service is an independent organization within the IRS that espouses to be the taxpayers' "voice at the IRS." See *The Taxpayer Advocate Service is Your Voice at the IRS*, IRS, <http://www.irs.gov/Advocate/The-Taxpayer-Advocate-Service-Is-Your-Voice-at-the-IRS> (last updated Mar. 14, 2014).

⁹⁶ See Heiberg, *supra* note 56, at 1706.

⁹⁷ *Id.*

⁹⁸ See, e.g., JOHN ADAMS, THOUGHTS ON GOVERNMENT (2010).

⁹⁹ Hiring Incentives to Restore Employment (HIRE) Act of 2010, Pub. L. No. 111-147, §§ 501-535, 124 Stat. 71, 97-115 (2010).

¹⁰⁰ *Global Forum on Transparency and Exchange of Information for Tax Purposes*, OECD,

consisted of OECD countries and jurisdictions that agreed to exchange tax-related information to achieve greater tax transparency.¹⁰¹ The Global Forum was restructured in 2009 to strengthen this exchange of information.¹⁰²

1. The Emergence of International Tax Standards

In 2009, the Group of Twenty (G20)¹⁰³ expressed willingness to sanction jurisdictions that were reluctant to adopt the tax standards of the 2002 OECD Model Agreement on Exchange of Information on Tax Matters and the OECD Model Tax Convention on Income and on Capital.¹⁰⁴ Since then, an ever-increasing number of countries have cooperatively adopted international tax standards, thereby indicating a willingness to set aside traditional notions of sovereignty on tax matters in exchange for transparent sovereignty—something that is critical for modern governance.¹⁰⁵

Initiatives to coordinate tax policies between countries have been proposed for years, especially because tax havens have become increasingly burdensome to industrialized countries.¹⁰⁶ Because most governments want to limit their use, the appropriate means of dealing with tax havens has become a vigorous debate.¹⁰⁷

2. Membership

As of November 2014, the Global Forum is comprised of 123 members, on equal footing, that are committed to implementing international standards of tax transparency and exchange of information.¹⁰⁸ Developing countries are invited to join the Global Forum and benefit from

<http://www.oecd.org/tax/transparency> (last visited Oct. 4, 2013).

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ Formed in the wake of the Asian financial crisis in 1999, the G20 is a bloc of nineteen countries and the European Union that meets annually to discuss “ways to strengthen the global economy, reform international financial institutions, improve finance regulation and implement the key economic reforms that are needed in each member economy.” *About G20*, G20, https://www.g20.org/about_G20 (last visited Aug. 21, 2014).

¹⁰⁴ Miguel González Marcos, *Seclusion in (Fiscal) Paradise is Not an Option: The OECD Harmful Tax Practices Initiative and Offshore Financial Centers*, 24 N.Y. INT’L L. REV. 1, 1–3 (2011).

¹⁰⁵ *Id.* at 5. Tax havens “(1) rob prosperous industrialized countries of their tax revenues; (2) permit too much bank, corporate and individual secrecy; and (3) lack vigor in the fight against money laundering.” *Id.* (internal quotations omitted) (citation omitted).

¹⁰⁶ *See id.*

¹⁰⁷ *See id.* at 6–7.

¹⁰⁸ *Members of the Global Forum*, OECD, <http://www.oecd.org/tax/transparency/membersoftheglobalforum.htm> (last visited Mar. 16, 2014).

these standards,¹⁰⁹ with members' compliance enforced through an in-depth peer review and monitoring process.¹¹⁰

B. Examining the Playbook: Keys to Success

The Global Forum's success is attributable to its emphasis on coordination, balance, and multilateral tax treaties. The following subsections explore each of those elements in greater detail.

1. Coordination

Coordination between countries is necessary to effectively address the cross-border problem of offshore tax evasion. But to facilitate and sustain intrajurisdictional cooperation, countries' respective tax revenues must be linked to their shared goals.¹¹¹ Specifically, industrialized countries must recognize and address developing countries' goals, such as equitable distribution of tax revenues, better resource allocation, discouragement of economic crimes, and furtherance of institutional quality and growth.¹¹² The process of reaching these multilateral agreements must also be fair, transparent, and participatory, granting equal footing to all potential signatories.¹¹³

2. Balance

Another impediment to securing and sustaining multilateral tax treaties is countries' legitimate fear of losing sovereignty.¹¹⁴ Balancing national sovereignty and compliance with international tax standards is critical because tax evasion is a global problem; it cannot be effectively overcome through national policies alone.¹¹⁵

Thus, countries that adopt international tax standards must reconcile their dual interests in maintaining national sovereignty and complying with

¹⁰⁹ *Frequently Asked Questions*, OECD, <http://www.oecd.org/tax/transparency/Frequently%20asked%20questions.pdf> (last visited Mar. 16, 2014).

¹¹⁰ *Id.* All Global Forum members undergo peer reviews of their implementation of international tax standards. These peer reviews involve the following two phases: (1) a review of each jurisdiction's legal and regulatory framework for tax transparency and exchange of information, and (2) a review and subsequent rating of the practical implementation of the tax standards. *Id.*

¹¹¹ See Marcos, *supra* note 104, at 30.

¹¹² *Id.* at 30–31.

¹¹³ *Id.* at 32.

¹¹⁴ *Id.* at 27.

¹¹⁵ *Id.* at 27–28.

foreign demands for transparency.¹¹⁶ In doing so, countries should consider (1) modifying their existing domestic tax laws to comply with international tax standards, (2) the negative effects of limiting access to FFIs, (3) the projected income loss from decreased offshore financial services and alternate sources of revenue, and (4) ways of balancing the exchange of information with foreign countries and domestic citizens' right to privacy.¹¹⁷

International tax standards can also produce inefficient results in the "global allocation of capital" if certain countries' domestic tax laws do not reflect principles of international tax neutrality.¹¹⁸ To avoid this undesirable hodgepodge, countries should collaboratively analyze how international tax standards can be used to provide developmental assistance.¹¹⁹

3. *Multilateral Tax Treaties*

In addition to coordination and balance, jurisdictions must consider how to adopt and implement international tax transparency and information exchange standards—unilaterally, bilaterally, or multilaterally. The United States currently has bilateral income tax treaties with sixty-eight countries.¹²⁰ However, bilateral tax treaties may be inadequate when jurisdictions' domestic tax policies closely resemble one another.¹²¹

In fact, bilateral tax treaties might even boost tax havens' appeal as destinations for establishing business ventures because of the superficial display of good governance that could result after entering into these treaties.¹²² Therefore, multilateral tax treaties are a long-term solution to combatting offshore tax evasion because they are better suited to foster cooperation and balance between countries seeking to adopt and implement international tax standards.¹²³

¹¹⁶ *Id.* at 34.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 22–23. Developing countries fear that tax coordination will only benefit their more industrialized counterparts. *See id.*

¹¹⁹ *Id.* at 23–24.

¹²⁰ *United States Income Tax Treaties – A to Z*, IRS, <http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z> (last updated Oct. 21, 2013).

¹²¹ Marcos, *supra* note 104, at 25–26.

¹²² *See id.* at 26. Because bilateral tax treaties do not promote international coordination, cooperation, or even coercion to the extent that their multilateral counterparts do, they are less likely to induce true tax transparency in signatory tax havens. *See id.* at 26 n.143.

¹²³ *Id.*

V. THE BLUEPRINT: IGAS

The Global Forum operates within a cooperative, balanced, and multilateral framework.¹²⁴ Countries on equal footing draft, adopt, and implement international standards of tax transparency and exchange of information.¹²⁵ But the Global Forum's impact is limited to individual countries' initiative to modify their domestic tax laws in compliance with international standards.¹²⁶ Unfortunately, the Global Forum lacks a punitive means of addressing noncompliant jurisdictions that denounce its message, or that just accept it superficially without making any tangible changes to their domestic tax laws.

By enacting FATCA and reforming its domestic tax laws, the United States wholeheartedly embraced the Global Forum's gospel.¹²⁷ Surprisingly, however, some of FATCA's foreign critics are also members of the Global Forum.¹²⁸ (*Et tu, Brute?*) Foreign banks, including those in countries belonging to the Global Forum, have also harshly criticized the legislation.¹²⁹

This backlash can be traced to FATCA's misplaced reliance on a bank-to-residence government (B2G) approach to international tax information reporting.¹³⁰ This section examines that misplaced reliance and then suggests a better approach that is already gaining traction—IGAs.

A. Fundamentally Flawed: The B2G Approach

FATCA's B2G approach leaves foreign governments completely out of the "information reporting chain" relying instead on full compliance by FFIs.¹³¹ While this approach provides greater simplicity, FATCA cannot realistically solve the United States' offshore tax evasion problem without collaborating with foreign governments.¹³² Additionally, levying the 30%

¹²⁴ See OECD, IMPLEMENTING THE TAX TRANSPARENCY STANDARDS: A HANDBOOK FOR ASSESSORS & JURISDICTIONS 7 (2010).

¹²⁵ *Id.*

¹²⁶ See, e.g., Angel Gurria, Sec'y-Gen., OECD, Opening Remarks at the Fourth Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Oct. 25, 2011) (stating that Belgium, Malaysia, Luxembourg, and the Philippines have taken *domestic action* to improve other countries' access to their tax information) (emphasis added).

¹²⁷ See generally *id.* (stating that the battle for fairer international tax laws involves countries amending their domestic tax laws).

¹²⁸ Behrens, *supra* note 10, at 210.

¹²⁹ *Id.* at 210–11.

¹³⁰ See Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529, 530 (2012).

¹³¹ *Id.*

¹³² *Id.* FFIs are unlikely to comply with FATCA, an exclusively American law, if doing so violates

withholding tax on noncompliant FFIs would inevitably damage the United States' relationship with both the FFIs and foreign governments.¹³³ Conversely, ineffectual enforcement of FATCA's provisions severely diminishes its viability as a means of combating offshore tax evasion.

B. Let Us Take a Moment and Give Thanks

It would be unfair, however, to continue discussing FATCA's flaws without also crediting the law for its innovative push towards increased transparency in international tax reporting and information exchange. First, FATCA's 30% withholding tax covers practically all returns from financial investment accounts.¹³⁴ FATCA's scope is also not limited to proceeds from gains on sale; it covers *all* gross proceeds from sales.¹³⁵ This is a noteworthy feat because collecting the right amount of taxes on U.S.-source investment returns is an age-old problem that FATCA's predecessor, the U.S. "qualified intermediary" (QI) program, did not adequately address.¹³⁶

Second, FATCA employs source withholding in requiring account disclosure regardless of whether the account generates U.S.-source income or if it is simply held by an FFI.¹³⁷ FATCA also effectively uses the threat of source withholding on U.S.-source investment accounts to prompt the disclosure of other accounts owned by U.S. citizens.¹³⁸

Third, FATCA requires FFIs to determine whether de facto U.S. ownership exists instead of simply relying on clients' assertions of their tax status or residence.¹³⁹ This is a sharp departure from the QI program's "know your customer" diligence rules that restricted additional investigation to situations where criminal activity seemed probable.¹⁴⁰ FATCA's stringent diligence requirements also contrast with the general principle that tax preparers can rely on taxpayers' representations absent a

their host country's bank secrecy laws, or if the costs of compliance greatly outweigh the continued benefits of retaining U.S. account holders.

¹³³ *Id.*

¹³⁴ *Id.* at 535.

¹³⁵ *Id.*

¹³⁶ *Id.* at 530, 532. The QI program did not provide the U.S. government with information about U.S. investors. Unlike FATCA, the model QI agreement also did not contain significant withholding penalties. But the QI program's biggest drawback was its broad definition of a "beneficial owner," which included corporations. Thus, to circumvent the QI program's rules, a U.S. taxpayer could form a non-U.S. shell corporation and list it as the account owner. Then, magically, a "bona fide non-U.S. person" would own the corporation, relieving it of compliance with the QI rules. *See id.* at 532–35.

¹³⁷ *See id.* at 535.

¹³⁸ *See id.*

¹³⁹ *See id.*

¹⁴⁰ *Id.* at 532, 533 & n.24.

valid reason to think otherwise.¹⁴¹

Finally, FATCA does not assume that a corporation is the beneficial owner. Instead it requires FFIs to report accounts in which a U.S. citizen holds more than 10% of the equity.¹⁴² In taking this approach, FATCA discards a traditional principle of American governance: treating corporations as taxpayers under U.S. federal income tax law.¹⁴³

Given the reasons described above, FATCA is undoubtedly an innovative piece of legislation, but impediments to its successful implementation include undesirable capital market disruptions, foreign bank secrecy laws that limit FFIs' means and extent of compliance, and the United States' limited jurisdiction to verify FFIs' compliance.

C. There is Another Way

Fortunately, B2G reporting is not the only approach to international tax information reporting. There is another way—IGAs. Many jurisdictions entered into IGAs with the United States after FATCA's enactment, so that they could comply with its reporting requirements in a way that did not violate their domestic banking or secrecy laws.¹⁴⁴ The following subsections will examine how IGAs mitigate conflicts between FATCA's reporting requirements and foreign jurisdictions' domestic laws.

1. IGAs for Dummies

FFIs, under FATCA, can avoid being withheld upon by registering with the IRS and agreeing to report specified information about U.S. accounts and foreign accounts with substantial U.S. owners.¹⁴⁵ This can be done in one of two ways: (1) Model 1 IGAs, or (2) Model 2 IGAs.¹⁴⁶ Model 1 IGAs are agreements between the United States and a foreign government regarding compliance with FATCA.¹⁴⁷ FFIs do not enter into

¹⁴¹ *Id.* at 536.

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ As of March 2014, more than forty jurisdictions have entered into signed IGAs with the United States. *FATCA – Archive*, U.S. DEPT OF THE TREAS., <http://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx> (last updated Sept. 29, 2014).

¹⁴⁵ *FATCA Information for Foreign Financial Institutions and Entities*, IRS, <http://www.irs.gov/Businesses/Corporations/Information-for-Foreign-Financial-Institutions> (last updated Mar. 17, 2014).

¹⁴⁶ See IRS, Rev. Proc. 2014-13, 2014-3 I.R.B., FINAL FFI AGREEMENT FOR PARTICIPATING FFI AND REPORTING MODEL 2 FFI (2014) [hereinafter Rev. Proc. 2014-13], available at http://www.irs.gov/irb/2014-3_IRB/ar10.html.

¹⁴⁷ Treas. Reg. § 1.1471-1(78) (2014).

FFI Agreements with the IRS under Model 1 IGAs.¹⁴⁸ Instead, FFIs make the required disclosures to their host country's government, which in turn provides this information to the IRS.¹⁴⁹

Model 1 IGAs come in the following two flavors: (1) reciprocal, and (2) nonreciprocal.¹⁵⁰ As their label indicates, reciprocal Model 1 IGAs require a dual exchange of information between the United States and a foreign government regarding their respective resident account holders.¹⁵¹ On the other hand, nonreciprocal Model 1 IGAs only require the foreign government to report this information to the United States.¹⁵² But regardless of whether the Model 1 IGA is reciprocal or nonreciprocal, both versions require FFIs to report specified information about accounts held by U.S. citizens or by foreign entities controlled by U.S. citizens.¹⁵³

Model 2 IGAs, on the other hand, require FFIs to directly report information to the IRS.¹⁵⁴ Under this approach, the foreign government enables FFIs within its jurisdiction to "register and 'comply with the requirements of an FFI Agreement, including . . . due diligence, reporting, and withholding.'"¹⁵⁵ FATCA permits FFIs to avoid its 30% withholding tax by entering into an FFI Agreement with the IRS, thereby agreeing to make required disclosures.¹⁵⁶

¹⁴⁸ RAYMOND J. HOLST, JIYEON LEE-LIM & WILLIAM LU, LATHAM & WATKINS LLP, INTERGOVERNMENTAL AGREEMENTS UNDER FATCA: COMPARING THE TWO MODELS 2 (2013).

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.* This required information includes U.S.-taxpayer identification numbers and payments to nonparticipating FFIs (institutions that do not comply with FATCA's provisions). *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* These disclosures are supplemented with additional exchanges of information between the IRS and the foreign government or its agency. Amy P. Jetel & Lauren Fitte, *IRS Releases Final FFI Agreement*, WEALTHMANAGEMENT.COM (Jan. 10, 2014), <http://wealthmanagement.com/estate-planning/irs-releases-final-ffi-agreement>.

¹⁵⁶ Jetel & Fitte, *supra* note 155. An FFI Agreement requires participating FFIs to do the following:

- (1) perform due diligence and to identify accounts held by U.S. persons;
- (2) report those accounts on Form 8966;
- (3) withhold and remit [a] 30 percent tax on accounts for which the withholding is required (and file the appropriate Forms 1042, if required);
- (4) report income on Form 1099 if it elects to perform full reporting (rather than 30 percent withholding) for an account holder that is a U.S. person;
- (5) retain certain information on U.S. accounts and comply with IRS requests for additional information;
- (6) furnish valid withholding certificates to each withholding agent from which it receives a withholdable payment; and
- (7) close certain accounts of "recalcitrant" account holders.

Id.

The IRS further differentiated between Model 1 and Model 2 IGAs on December 26, 2013 when it published Revenue Procedure 2014-13 (Final Agreement), which pertains to FFIs entering into an FFI Agreement (participating FFIs) and FFIs treated as reporting institutions under Model 2 IGAs.¹⁵⁷ Interestingly, the Final Agreement does not address Model 1 IGAs.¹⁵⁸ Therefore, Model 1 IGAs permit FFIs to comply with FATCA's reporting requirements without having to enter into an FFI Agreement with the IRS.¹⁵⁹ Conversely, Model 2 IGAs require signatory jurisdictions to comply with the terms of an FFI Agreement.¹⁶⁰

2. *Apples to Apples?: Comparing Model 1 and Model 2 IGAs*

The following subsections compare the due diligence, information reporting, withholding, and enforcement provisions of Model 1 and Model 2 IGAs. This comparison is then used to evaluate each IGA model's respective impact on FFIs and their host government.

a. Due Diligence

Both IGA models have similar due diligence requirements. Model 1 IGAs contain a section entitled Annex I, which lists due diligence requirements to guide FFIs in determining what information to report to the IRS.¹⁶¹ Alternatively, signatories to Model 1 IGAs may permit their FFIs to adopt the Regulations' stricter due diligence requirements.¹⁶² Model 2 IGAs also contain an Annex I section that lists due diligence requirements for FFIs.¹⁶³ Like Model 1 IGAs, Model 2 IGAs permit FFIs to alternatively apply the Regulations' requirements.¹⁶⁴ But if FFIs choose to apply the Regulations' requirements, they must continually do so unless there is a "material modification to the Regulations."¹⁶⁵ Additionally, Model 2 IGAs

¹⁵⁷ *Id.*; see also Rev. Proc. 2014-13, *supra* note 146.

¹⁵⁸ Jetel & Fitte, *supra* note 155.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ HOLST, LEE-LIM & LU, *supra* note 148, at 2.

¹⁶² *Id.* "Regulations" refer to the final and temporary regulations revising FATCA's provisions released by the Treasury Department and the IRS. See generally *Foreign Account Tax Compliance Act*, IRS, <http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA> (last updated Sept. 15, 2014).

¹⁶³ HOLST, LEE-LIM & LU, *supra* note 148, at 2.

¹⁶⁴ *Id.* at 2-3.

¹⁶⁵ *Id.* Nonexclusive examples of material modifications include changes to the following:

[1] The yield of a debt instrument by more than the greater of 25 basis points or 5% of the annual yield[;]

[2] The timing of payments on a debt instrument that results in a material deferral of

require FFIs to comply with the terms of an FFI Agreement.¹⁶⁶

b. Information Reporting

In addition to the due diligence requirements discussed above, each IGA model requires specified information reporting by FFIs. Under Model 1 IGAs, FFIs must report specified information to their host governments that, in turn, provide this information to the IRS.¹⁶⁷ This exchange of information compels foreign governments to adopt and enforce laws requiring FFIs to comply with FATCA-mandated disclosures.¹⁶⁸ Providing this information to the IRS is also an added administrative and financial burden for foreign governments.¹⁶⁹ On the bright side, however, the growing pains might be worthwhile if the foreign government wants U.S. financial institutions to reciprocate information about its citizens.¹⁷⁰

Unlike its Model 1 counterparts, Model 2 IGAs cut out the middleman by requiring FFIs to directly report information to the IRS.¹⁷¹ But unfortunately for foreign governments, Model 2 IGAs still involve some administrative and financial costs if the IRS seeks additional information about a U.S. account holder.¹⁷²

c. Withholding

Neither IGA model subjects FFIs to FATCA withholding on payments received or made, as long as the FFIs comply with their governing IGA's requirements.¹⁷³ But, unlike Model 1 IGAs, Model 2 IGAs have a bite. If the IRS requests additional information about an account and the foreign government fails to respond within six months, FATCA requires FFIs to

scheduled payments[;]

[3] The obligor or security underlying a debt instrument[; and]

[4] The nature of the obligation that causes it not to be a debt instrument.

Final FATCA Regulations Training Session #1: Update on Changes to Withholding & Grandfathered Obligations, CITIBANK (June 2013), http://www.citibank.com/transactionservices/home/about_us/online_academy/materials/docs/fatca_withholding.pdf.

¹⁶⁶ HOLST, LEE-LIM & LU, *supra* note 148, at 3. Adherence to the terms of an FFI Agreement is not required if a specific Model 2 IGA's terms provide otherwise. *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* Model 2 IGAs oblige foreign governments to obtain and provide requested, additional information to the IRS. *See id.*

¹⁷³ *Id.* at 4. FFIs that fail to comply with the requirements of their governing Model 1 IGA are not subject to FATCA withholding unless the IRS labels them as nonparticipating financial institutions. *Id.*

withhold when paying the account “(i) [U.S.-source] FDAP income, (ii) gross proceeds from the disposition of property of a type that can produce [U.S.-source] dividends or interest or (iii) foreign passthru payments.”¹⁷⁴ This withholding requirement also applies when FFIs make any of these three types of payments to nonparticipating FFIs.¹⁷⁵

Unsurprisingly, FFIs prefer Model 1 IGAs because FATCA withholding under them is not dependent on host governments providing requested information to the IRS within six months.¹⁷⁶ Compared to Model 2 IGAs, Model 1 IGAs also impose less withholding responsibility on FFIs.¹⁷⁷

d. Enforcement

Lastly, there is the issue of enforcement. Model 1 IGAs require foreign governments to enact and enforce local laws to ensure that FFIs comply with their governing IGA’s requirements.¹⁷⁸ But under Model 2 IGAs, foreign governments do not have an enforcement role.¹⁷⁹ Thus, Model 1 IGAs provide FFIs with an advantage that Model 2 IGAs lack—interaction, from the onset, with their host governments regarding compliance with FATCA.¹⁸⁰ Model 1 IGAs also provide foreign governments with advantages, including increased control of FFIs within their jurisdiction and greater transparency regarding the FFIs’ compliance with FATCA’s provisions.¹⁸¹

3. Survey Says: OECD Agrees!

With FATCA and the IGA models described above paving the way, G20 leaders endorsed the OECD proposal of an international information exchange model in September 2013.¹⁸² This endorsement came on the

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *See id.* at 4–5.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 5. If an FFI is noncompliant with its obligations under its governing Model 1 IGA for longer than eighteen months, the IRS may place the FFI on a nonparticipating financial institutions list, thereby subjecting it to FATCA withholding on payments received. *Id.*

¹⁷⁹ *Id.* If an FFI is noncompliant with its obligations under its governing Model 2 IGA for twelve months or more, the IRS may place the FFI on a nonparticipating financial institutions list, thereby subjecting it to FATCA withholding on payments received. *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² OECD, STANDARD FOR AUTOMATIC EXCHANGE OF FINANCIAL ACCOUNT INFORMATION 44 (2014) [hereinafter STANDARD FOR AUTOMATIC EXCHANGE], available at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-information-in-tax->

heels of many European countries announcing their intention to implement FATCA.¹⁸³ In February 2014, the G20 leaders invited the OECD to propose a specific standard for consideration by the G20 Finance Ministers and Central Bank Governors.¹⁸⁴

Subsequently, the OECD published a 2014 report containing the Common Reporting Standard (CRS), which specifies reporting and due diligence procedures for financial institutions.¹⁸⁵ The CRS, which to a large extent was inspired by FATCA,¹⁸⁶ contains a reporting and due diligence standard that implementing jurisdictions must locally adopt and enforce.¹⁸⁷ In this regard, the CRS shares some similarities with Model 1 IGAs because both information-reporting mechanisms require collaboration with foreign governments. But unlike the IGA models, which are distinguishable from one another and which seek to primarily benefit the United States' efforts in curbing U.S. tax evasion, the purpose of the CRS is to facilitate a standard international model of automatic information exchange. Thus, the CRS seeks to avoid the proliferation of varying, complex, and expensive standards for foreign governments and their financial institutions.¹⁸⁸

Even though the CRS deviates from the IGA models in some respects,¹⁸⁹ both approaches are generally compatible because they adopt an intergovernmental, reciprocal approach to international tax information reporting.¹⁹⁰ In addition to the CRS, the 2014 OECD report contained a model competent authority agreement or arrangement (Model CAA), which specifies rules governing the exchange of tax information that can be executed within existing legal treaties or agreements.¹⁹¹

The 2014 OECD report also highlighted the following factors as crucial to a successful automatic exchange model: (1) a common standard on information reporting, due diligence, and exchange of information; (2) a legal and operational basis for the exchange of information; and

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¹⁸³ *Id.* at 5. On April 9, 2013, Ministers of France, Germany, Italy, Spain, and the United Kingdom stated they would exchange tax information, similar to that required under FATCA, among themselves and with the United States. On April 13, 2013, Belgium, the Czech Republic, the Netherlands, Poland, and Romania announced similar intentions. By May 14, 2013, seventeen countries endorsed a multilateral tax information exchange approach. Soon afterwards, Mexico, Norway, and Australia joined the club. *Id.*

¹⁸⁴ *Id.* at 6.

¹⁸⁵ *Id.* at 6–7.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.* at 6.

¹⁸⁹ *Id.* at 7. Key differences include FATCA's U.S. citizenship-based model and its withholding tax.

Id.

¹⁹⁰ *Id.*

¹⁹¹ *Id.* at 3.

(3) common or compatible technical solutions.¹⁹² The first factor entails developing a wide scope for financial information that must be reported¹⁹³ and then imposing these reporting requirements on an equally wide scope of account holders¹⁹⁴ and financial institutions.¹⁹⁵ Furthermore, effective procedures need to be established to ensure the quality and accuracy of the relayed information.¹⁹⁶

The second factor, a legal and operational basis for the exchange of information, seeks to establish a multilateral exchange instrument to facilitate information reporting in lieu of the bilateral treaties that currently exist.¹⁹⁷ The greatest advantage of a multilateral approach is its international reach, which promotes administrative cooperation and transparency between jurisdictions.¹⁹⁸ Lastly, the third feature, common or compatible technical solutions, requires standardization of reporting to keep costs down for all participating jurisdictions.¹⁹⁹

VI. PUTTING IT ALL TOGETHER

FATCA is an innovative and bold piece of legislation. It is a no-holds-barred Congressional crackdown on U.S.-source piggy banks stashed overseas. But FFIs and foreign governments do not have to comply with an exclusively American law, especially where the perceived headaches associated with compliance outweigh the anticipated benefits. Fortunately, Model 1 and Model 2 IGAs between the United States and foreign governments provide a cooperative, coordinated, and transparent solution.

Still, bilateral IGAs are just the tip of the iceberg; their impact on global information reporting is limited to the signatory jurisdictions. Different jurisdictions' IGAs will also inevitably contain varying requirements and enforcement mechanisms. This adds greater complexity and confusion to an already complex and confusing system of global tax information reporting.

¹⁹² *Id.* at 7–9.

¹⁹³ *Id.* at 7–8. The scope should be wide enough to include various sources of investment income (e.g., interest, dividends, etc.). *Id.*

¹⁹⁴ *Id.* “Account holders” should be defined in a manner that prevents individuals from avoiding their obligation to report tax information through “interposed legal entities or arrangements.” *Id.*

¹⁹⁵ *Id.* at 8. The scope of financial institutions subject to required reporting should include banks, brokers, and insurance companies. *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 9.

The United States must therefore continue working with the OECD towards the adoption of a multilateral, automatic information exchange standard, which will enhance tax transparency and reduce tax evasion at an international level. Wide-scale adoption of a standardized model will also reduce the administrative costs of implementation, in addition to simplifying compliance procedures for participating jurisdictions. Consequently, nonparticipating jurisdictions will find it increasingly difficult to resist joining the kumbaya.

Tax evasion is not a uniquely American problem. Its solution should not be either.