The New Global Landscape

Transparency—The Rule of the Day

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A quick scan of almost any global economic news reveals a virtual tsunami of new reporting requirements for individuals, and information exchange agreements between countries. The impetus behind this dramatic escalation is two-fold: a growing desire to combat money laundering, and the recognition that a crackdown on tax evasion may be a primary way to satisfy the urgent need for more government revenue. These trends are especially evident in the more developed countries.

The United States was among the first and largest countries to request client information from foreign financial institutions, and has faced considerable resistance. Challenges have ranged from claims of overreaching territoriality to conflicts with local privacy laws. However, in recent years, many countries have gradually accepted and even adopted similar laws and reporting requirements. Led by the historically richer nations in Europe and North America, countries around the globe are proactively exploring and engaging in bilateral exchange agreements.

In addition, the Organization for Economic Cooperation and Development (OECD) is encouraging multilateral cooperation and the automatic exchange of information. In August 2013, China joined 56 other countries in signing the OECD Convention on Mutual Administration Assistance in Tax Matters and is working with other G20 countries to develop a global standard for mutual information exchange. Further, increasing numbers of so-called "tax havens" are acquiescing to sharing various levels of detail regarding accounts and assets belonging to the citizens of other countries.

The United States Leads the Charge

Although commonly considered a recent development, the United States has had reporting requirements for non-U.S. assets for decades. However, the extent and enforcement of such regulations have grown exponentially in recent years.

U.S. enforcement has extended to pursuing advisors who have helped foreign nationals evade taxes by structuring their investments offshore. The first step in this direction was in 2009 when UBS was forced to turn over the names of more than 4,000 clients to U.S. authorities, and one of the firm's employees, Bradley Birkenfeld, provided the U.S. government with information about his U.S. clients in the hopes of a reduced prison sentence. The case continued when Raoul Weil, ex-head of wealth management at UBS and Birkenfeld's former boss, was extradited from Italy to the U.S. to face charges of conspiracy to commit tax fraud.

NON-COMPLIANCE PENALTIES CAN BE STEEP: TWO RECENT CASES

In June 2014 a federal jury in Miami found Carl Zwerner guilty of willful failure to file FBARs disclosing his Swiss bank account for years 2004-2006. He faces a fine of more than $2 million, on account balances close to $1.5 million, due to the penalty of 50% of the balance for each year of non-disclosure.[4]

Ty Warner, the creator of Beanie Babies, is a billionaire with a net worth of $2.6 billion. He opened an account in 1996 and moved it to Zucher Kantonal Bank in 2002 under the name Malong Foundation. The balance was believed to be $94 million. He allegedly earned $3.1 million in this investment in 2002 but did not tell his U.S. accountants or report it on his U.S. tax returns, avoiding $885,200 in taxes. He claims to have come forward voluntarily in 2009 to enter the Offshore Voluntary Disclosure Program (OVDP), but was denied entry because he was under government scrutiny. He later agreed to plead guilty to one felony count of tax evasion and paid a penalty of almost $54 million, the largest offshore account penalty ever reported. But this was just the beginning. He also paid $27 million in back taxes and interest. In January, he was sentenced to two years of probation and 500 hours of community service by a U.S. Federal District Court judge.[5] Since then, U.S. attorney for Northern Illinois Zachary T. Fardon is seeking Department of Justice approval to appeal Warner's no-jail sentence—a rare appeal that must also be approved by the U.S. Solicitor General.

Later in 2013, Swiss attorney and financial advisor Edgar Paltzer pled guilty in federal court in New York to conspiracy charges for allegedly helping U.S. taxpayers hide money offshore. Mr. Paltzer promised to cooperate fully with the U.S. government in exchange for leniency in his sentencing. By August 2013, 35 advisors had been criminally charged.[1] In March 2014, former Credit Suisse AG banker Andreas Bachmann pled guilty to conspiring to defraud the Internal Revenue Service (IRS) through his banking and investment services to U.S. customers. The plea later evolved into a more extensive case against Credit Suisse, culminating in May with the bank agreeing to plead guilty to criminal tax evasion and pay a fine of more than $2.5 billion. Heightened U.S. enforcement is putting more pressure on U.S. persons with undeclared foreign accounts, as their advisors may choose to reveal client information rather than risk harsh penalties themselves. Since the UBS settlement, which cost the bank $780 million in penalties for helping U.S. clients hide assets, criminal charges have been brought against more than 80 U.S. persons.[2] Further, the government's reach has expanded to include assets stored in bank vaults. Five bank vaults in Zurich, controlled by attorney Paltzer, were sealed by court order due to suspicion that they were being used to store "hard assets" such as art and jewelry.

More recently, two U.S. federal courts authorized the IRS to issue summonses to five major U.S. banks, requiring them to furnish information regarding U.S. taxpayers who may be evading U.S. taxes on assets held at certain Swiss banks which maintain correspondent accounts with the U.S. banks.[3] By obtaining this information through correspondent accounts in U.S. banks, the IRS is able to gain access to information about a large number of taxpayers, unhindered by bank secrecy laws in Switzerland or other countries.

FINCEN and FBAR: the Foundation for Heightened Enforcement

One of the earliest efforts targeting "foreign" accounts was the Foreign Bank & Financial Accounts (FBAR). Under the mandate of the Bank Secrecy Act of 1970, the Financial Crimes Enforcement Center (FINCEN), a law enforcement agency of the U.S. Treasury, designed this report with the primary goal of identifying possible money laundering. U.S. persons and entities with interests in and/or signing authority over foreign financial accounts must file this form by June 30 for every year in which the market value of their non-U.S. assets totals $10,000 or more.

Prior to October 1, 2013, the FBAR was filed on Form TD F 90-22.1, which was sent to the U. S. Treasury. Effective July 1, 2013, affected taxpayers must register with FINCEN, obtain a user id and password, and file electronically on FINCEN Form 114. As savvy advisors have already noted, this new procedure makes it much easier for the U.S. government to utilize the information on the FBAR and compare it with account information on other forms. Further, a recent case revealed that the reverse is also true. The IRS is opening FBAR investigations as a result of

information included on tax returns. At least one district court has ruled that the IRS has this authority.[6]

Non-compliance penalties may be extremely high, as outlined in the sidebar on the prior page. Civil penalties can go up to the greater of $100,000 or 50% of the account balance, assessed annually for each year of delinquency. In addition, criminal penalties include fines of up to $250,000 and prison terms of up to five years. In the early decades after enactment, the FBAR requirement was neither well known nor aggressively enforced. However, the U.S. government currently considers compliance a priority and has assessed harsh penalties in some high profile cases, possibly as examples. Penalties can be reduced and possibly even waived for taxpayers who can convince the IRS that their failure to file was not "willful," and/or was due to "reasonable cause." However, the IRS is generally taking a hard line on this, and does not consider "ignorance" an acceptable excuse.

Enforcement is likely to increase further. Despite much broader public awareness, the U.S. government estimates that FBARs continue to be seriously underutilized. Approximately 671,000 FBARs were filed in 2012—a decrease from the 720,000 filed in 2011.[7] Advisors hypothesize that the decline may be a result of U.S. taxpayers closing their foreign accounts in the face of the heightened reporting requirements. This is discussed in greater detail later in this paper. (See page 6.)

Particular attention is now being focused on trusts. Assets in revocable grantor trusts must usually be reported by the grantor on his or her FBAR, along with other foreign assets. The rules are more complex for irrevocable and non-grantor trusts. Grantors, trustees and beneficiaries of trusts with offshore assets or situs should consult an advisor who specializes in international taxation.

FATCA Takes Enforcement to a New Level

In March 2010 President Obama signed into law the "Hiring Incentives to Restore Employment Act" (HIRE Act). Included as part of the HIRE Act is the Foreign Account Tax Compliance Act, or FATCA. Designed to prevent tax evasion by U.S. persons who use foreign accounts and investments, FATCA provides the U.S. government with the necessary tools to effectively determine the ownership of foreign accounts and investments belonging to U.S. persons. In doing so, it significantly increases the reporting responsibilities for both financial institutions and individuals associated with non-U.S. assets.

FATCA attacks tax evasion on multiple fronts. Below are the main compliance implications for individuals, trusts and entities other than those classified as "financial institutions." Ramifications for financial institutions are reviewed in the next section of this paper.

Individuals: For tax years beginning after 2010, U.S. taxpayers are required to report foreign financial accounts and assets, including foreign investment funds, on the new FATCA form 8938. Specifically, U.S. persons with at least $50,000 at year end or $75,000 any time during the year in certain foreign financial assets must report details annually on the form. The thresholds are doubled if married and are higher for U.S. persons living outside the U.S. Additionally, U.S. persons will face increased verification and due diligence on the part of both foreign and domestic financial institutions with whom they do business.

Reportable assets do not include tangibles, foreign currency, precious metals or real estate; however, if these are held in a foreign entity, interests in the entity are "specified foreign financial assets", and must be reported.

It is important to note that FATCA reporting requirements apply not only to U.S. citizens and resident aliens, but also to dual citizens and to non-resident aliens who are taxed as U.S. residents due to the "substantial presence" test and/or election under IRC 6013(g) or (h).

Trusts: There continues to be confusion regarding the reporting requirements and procedures for foreign trusts. Foreign grantor trusts are reported by the grantor on Form 8938, and can be done in an abbreviated format with a reference to the trust's Form 3520A. But there are many open issues in the area of foreign non-grantor trusts. Only some of the questions were resolved with the IRS' "Final Regulations" of January 2013.

Entities: U.S. corporations, partnerships and other entities which own foreign assets will also be required to report. However, this was postponed pending the release of revised regulations and forms.

Penalties under FATCA could be severe: up to $50,000 for non-reporting, plus 40% on understated taxes, and possible criminal and/or fraud penalties of up to 75% of the value of the undisclosed assets.

The potential additional revenue to the U. S. Treasury could also be significant. The U.S. Joint Committee on Taxation estimates that compliance with FATCA reporting will raise $8.78 billion over the next ten years.[8]

Additional Reporting of Non-U. S. Assets

There are a number of other reports which may apply to U. S. persons with financial connections outside the U.S. While many of these forms are not new, enforcement and the amount of detail has been greatly expanded.

Form 3520 is used to report transactions between U.S. persons and foreign trusts, if the transactions total more than $10,000 in a year. In addition, Form 3520A is an annual information return that is required for a foreign trust with a U.S. "owner." U.S. persons with offshore entities are responsible for filing various combinations of Forms 5471, 5472 and 926 to report transactions with and ownership interests in foreign corporations, while Forms 8865, 8858 and 8621 apply to disregarded foreign entities such as partnerships. FATCA has expanded the reporting requirements for Form 8621 to include disclosing ownership in a Passive Foreign Investment Company (PFIC), even if there is no taxable activity. However, the actual filing of the expanded Form 8621 has been delayed pending finalization of the form itself.

In the current era of heightened scrutiny, it is increasingly important to ensure that these forms are accurate and are filed timely, as outlined in the sidebar at right.

Amnesty through Offshore Voluntary Disclosure Program (OVDP)

For a number of years, the U.S. Treasury has offered a series of amnesty programs in an attempt to capture a greater portion of the tax revenue lost due to unreported assets and income. These initiatives have been designed to incentivize U.S. persons with unreported foreign accounts and income to voluntarily resolve their delinquencies.[10]

The first of these Offshore Voluntary Disclosure Programs was offered in 2003. A second opportunity opened in March 2009. These early programs featured maximum penalties ranging from 5% to 20% of unreported assets plus a potential

FILING ERRORS CAN BE COSTLY: U.S. V. SIMON

The U.S. government highlighted its commitment to pursue "tax evaders" by litigating up to the appellate court. "Simon" was an ideal case for both the IRS and the Department of Justice to pursue, as it was replete with egregious behavior on the part of a professional advisor. James Simon, CPA and Professor of Accounting, was delinquent in filing several year of FBARs. Further, he had avoided paying taxes on $1.8 million of distributions from foreign trusts to him and his family by misclassifying these as loans. When he attempted to come clean, he did not comply with all the reporting requirements. The 7th Circuit Court of Appeals confirmed the district court's conviction on charges of four years of tax evasion and three years of annual FBAR non-compliance. While admittedly this is a classic case of "bad facts", it is indicative of the government's zeal in cracking down on non-compliance in the area of foreign assets.[9]

accuracy penalty of 20% to 40%, and a greatly reduced risk of criminal prosecution. Available only through October 2009, this program resulted in the reporting of close to 15,000 offshore accounts. The window reopened from February 2011 through September 2011, and again in June 2012. Although with each iteration the penalties have become progressively higher, the parameters have been similar. They all require that the disclosure be timely; i.e., that taxpayers submit amended returns disclosing and paying tax on all previously unreported income, and that they come forward before their names surface as part of an IRS investigation.

Taxpayers can also enter the OVDP but opt out of the standard penalties in favor of an individual examination by the IRS. This may result in lower penalties but could be cumbersome, costly and risky. An individual IRS examination includes a full audit of the past eight years, and the outcome is uncertain, as the IRS has broad discretion in assessing penalties.

From 2009 through August 2013, an estimated 38,000 U.S. persons have gone through the OVDPs. This has generated an estimated additional $5.5 billion in tax revenue, with an expected further $5 billion in the pipeline.[11] The latest version is still open, with no defined termination date.

Although experienced advisors who specialize in international investing have encouraged their clients to "come clean" now, rather than risk increasingly severe penalties and possible prison time, there appear to be a large number of U.S. persons who continue to be unwilling to disclose or are unaware of the filing requirements for non-U.S. interests. In 2012, the Taxpayer Advocate Report to Congress sharply attacked the IRS for poor dissemination of information and harsh treatment of innocent persons as part of the renewed crackdown. This further deterred recalcitrant taxpayers from rectifying their delinquent filing status.

Sensitized to the growing criticism and potential enforcement problems, the IRS in June 2012 released IR 2012-64/65. Aimed at U.S. non-resident taxpayers and dual citizens with unintentional violations, the rule provides for some leniency and a safe harbor for "low risk" taxpayers. To prove the non-disclosure was not willful, a person must have lived outside of the U.S. for many years; have unreported assets only in the foreign country of residence, rather than in a so-called tax haven; and have minimal undisclosed income of less than $1,500.

On June 18, 2014 the IRS announced a further streamlined procedure for taxpayers who certify that their non-disclosure was not due to "willful misconduct." Designed for people who were not intentionally hiding assets offshore, this process provides for maximum penalties of 5%.[12]

New Opposition to Global Crackdown

Many U.S. taxpayers are understandably not happy with the heightened reporting and higher tax bills. Those who disagree have demonstrated their dissatisfaction in several ways, from "quiet" disclosures to expatriation.

Quiet ("Silent") Disclosures

Despite the prospect of freedom from criminal prosecution and the certainty of settling with the IRS under the OVDP, a number of U.S. taxpayers have chosen to unofficially acknowledge their foreign accounts and/or income merely by filing current and/or amended returns. By including the appropriate information regarding their non-U.S. assets and income in this way, they hope to avoid the penalties of the official amnesty program. However, following a report by the General Accounting Office (GAO), which criticized the IRS for its leeway in allowing such disclosures to slip through, the U.S. Treasury has made it a priority to target these so-called "quiet disclosures." At the suggestion of the GAO, the IRS is enhancing procedures for identifying quiet disclosures. As illustrated in the example outlined in the sidebar below, quiet disclosures have resulted in steep penalties.

Expatriation: A Growing Number of Taxpayers Renouncing Citizenship

Another manifestation of public resistance is the exponential increase in the number of U.S. taxpayers renouncing their citizenship. In 2013, 3,000 U.S. persons gave up their American citizenship. This is triple the prior five year average.[14]

QUIET DISCLOSURES CAN SOMETIMES BACKFIRE: THE MICHAEL SCHIALVO CASE

Michael Schialvo was a sophisticated businessman and investor who opened an account at HSBC Bank Bermuda. In 2006, he deposited income from venture capital in UBS AG and then wired it to his HSBC account. He did not declare $99,273 of the income on his income tax return or FBAR. In 2009, he tried a "quiet" disclosure by filing FBARs and amended tax returns. He did not participate in the voluntary disclosure program. He was later investigated by the IRS Criminal Investigation Division and received a civil penalty of $76,283 for failure to file FBAR. He also faces five years in prison, three years of probation and a $250,000 fine.[13]

Since new IRS statutes 877 and 877A were enacted in June 2008, the cost of expatriation can be high. U.S. persons with a net worth greater than or equal to $2 million and/or an average income for the past five years that is greater than or equal to $157,000 (2014 amount, indexed for inflation) face an "exit tax" equal to the top capital gains tax rate on the excess of the market value over the cost of all liquid assets over $680,000 (2014 amount, indexed for inflation). In addition, for the rest of their lives, they are deemed to remain "covered expatriates," and will pay taxes at the top gift tax rate on any further gifts or bequests to U.S. persons, with no gift or estate tax exemption. They will only have the annual exclusion amount of $14,000 (2014 amount, indexed for inflation), per recipient per year.[15]

Expatriation used to be viewed with resentment and even suspicion by U.S. citizens. However, for the 7.2 million U.S.[16] persons living outside the U.S., particularly those who have no intention of returning to the U.S., formal expatriation can be compelling. American citizens in foreign countries face difficulties ranging from the basics—finding a bank that will open an account for them—to the more complex, such as purchasing life insurance or getting a mortgage. With the additional compliance cost of serving an American taxpayer estimated at $5,000 per person per year, foreign financial institutions are reconsidering the challenges of taking on U.S. clients.

Programs such as the unilateral "accord" allowing many Swiss banks to avoid prosecution for their role as custodian of undeclared assets of U.S. clients have only exacerbated the trend to stop serving U.S. clients. For instance, the cost of complying with this particular program include paying fines which, to quote the Swiss Bankers Association, "are at the upper end of legally acceptable and economically bearable levels."[17] Furthermore, expatriate Americans themselves face significant additional annual accounting fees due to the increasingly burdensome reporting. The 13.3 million resident aliens currently in the U.S. face a similar situation.[18]

Some recent high profile expatriations have fueled the interest in this tactic. In October 2013, rock star Tina Turner signed a "Statement of Voluntary Relinquishment of U.S. Citizenship" under Section 349(a)(1) of the Immigration and Naturalization Act. Of note is her apparent attempt to avoid the exit tax on all her worldwide assets by adopting Swiss citizenship and "relinquishing" rather than "renouncing" her U.S. citizenship. Time will tell whether this is a viable tactic.

Heightened Scrutiny by the Media

Mass media is taking notice and publishing news and opinion pieces criticizing the seemingly burdensome and invasive new laws. *The Wall Street Journal* ran an Op-Ed which called FATCA "a dragnet with revolutionary intent."[19] *The Economist* has also taken up the cause. An article in the October 12-18, 2013 issue entitled "Expats and Tax: Overtaxed and Over There" expounded on the difficulties and inequities faced by people caught in the web of U.S. taxation. Particular emphasis was placed on those who are "accidental Americans," having been born in the U.S. but who have spent most of their lives elsewhere. A follow-up Letter to the Editor in the October 26-November 1 issue gave a personal account of the challenge for Swiss Americans, whom are being asked to close their Swiss bank accounts, allegedly due to an abundance of caution on the part of Swiss banks after the recent lawsuits by the U.S.[20]

Some Lawmakers are Pushing Back

There has also been legislation introduced to repeal FATCA's invasive provisions, as some legislators are

concerned about the broad reach of the FATCA requirements and the related tax treaties and intergovernmental agreements. In the spring of 2013, U.S. Sen. Rand Paul, R-KY, introduced Senate Bill 887 to repeal FATCA. The bill contends that FATCA "undermines Americans' constitutional privacy protections and adds burdensome regulations with a negative economic impact on the United States."

Around the same time, the Florida Bankers Association and Texas Bankers Association filed a lawsuit against the U.S. Treasury and the IRS, in an attempt to block the full implementation of FATCA. The bankers objected to the reciprocal exchange of information under FATCA, fearing that they would lose their very large foreign client base if they had to reveal information which would be shared with clients' home countries. They claimed that resident aliens were already withdrawing significant deposits, in anticipation of the 2014 implementation of FATCA. The U.S. Department of Commerce estimates that foreigners have $3.6 trillion in deposits and investments with U.S. banks and securities brokers.[21] This lawsuit was dismissed by a U.S. Federal judge in January. To date it is uncertain whether, and in what form, U.S. bankers and their associations may pursue this issue.

The Global Perspective: Countries Respond with Intergovernmental Agreements ("IGA")

As noted earlier, FATCA is designed to combat tax evasion by imposing new reporting requirements not only on individuals but on financial institutions. Arguably the burdens on entities which fall under FATCA's broad definition of "financial institutions" are even more onerous, as outlined below.

U.S. Financial Institutions (USFIs): FATCA creates new U.S. tax reporting and withholding requirements for payments made to foreign financial institutions and foreign persons. Effective July 1, 2014, U.S. financial institutions must withhold 30% on certain U.S.-source income paid to any individual or legal entity deemed to be non-compliant for FATCA. This includes "Non-participating Foreign Financial Institutions" (NPFFIs), and "Non-financial Foreign Entities" (NFFEs) who fail to disclose "substantial" U.S. owners. This withholding tax is not intended to raise revenue. Rather it is intended to force compliance by entities that are beyond the reach of U.S. regulatory jurisdiction.

Foreign Financial Institutions (FFIs): In order to comply with FATCA and avoid withholding tax, FFIs are required to become "Participating FFIs" (PFFIs) by entering into an agreement with the IRS. The definition of FFI is extremely broad, and includes not only traditional banks and brokers, but a broad range of investment and securitization vehicles, certain insurance companies and investment managers and trustees.

The FFI agreement includes the following provisions[22]:

- PFFIs must conduct due diligence and account remediation on existing accounts and implement new procedures for all new accounts opened after July 1, 2014. They must be able to demonstrate that they have identified all U.S. citizens and residents, including dual residents, and ensure that they have appropriate documentation on file for all existing accounts.
- PFFIs must report to the IRS on an annual basis certain information about these U.S. account holders.
- PFFIs must also identify and report on accounts held by NPFFIs and so-called "recalcitrant clients" who either refuse to supply identifying documentation relevant to their FATCA status or, if they are U.S. persons, fail to waive any local legal restrictions on reporting relevant information to the IRS.

Finally, PFFIs must join USFIs in enforcing FATCA by imposing a 30% withholding tax with respect to U.S.-source income paid to NPFFIs and recalcitrant account holders.

In recognition of the complexity of these new requirements and the resulting burden on financial institutions, the IRS has periodically extended deadlines and temporarily relaxed the enforcement. For instance, on May 2, 2014, the IRS issued Notice 2014-33, designating 2014-2015 as a transition period during which withholding agents who act in good faith will not be held liable for errors in

withholding amounts and/or reporting. This Notice also extended the deadline to December 31, 2014 for withholding agents and FFIs to obtain new forms such as the Form W-8BEN-E.

Many foreign countries have resisted FATCA, on grounds of illegality or otherwise. At the same time, many countries have agreed to enter into IGAs with the U.S. (and, indeed, with each other). These IGAs have provided participating countries with reciprocity and a way to comply with FATCA in their own, and less onerous, terms. In essence, FATCA has had the effect of providing encouragement to the rest of the world to accelerate the movement towards global tax transparency.

Under an IGA, the partner country agrees to draft and implement local laws that will achieve FATCA's policy objectives. The effect of an IGA is to exempt impacted businesses in the partner country from the punitive FATCA withholding regime. The IRS is currently in negotiations with over 70 countries to sign IGAs; 27 had been signed as of the end of April 2014 with approximately 30 more having come to an agreement in substance. In return for complying with FATCAs policy objectives, the partner countries benefit in several ways:

- All financial institutions resident in an IGA country are immediately FATCA compliant and are no longer subject to potential withholding, even if local rules are not implemented immediately. This has even been extended to all countries who are deemed to have an "agreement in substance."
- Certain types of entities are taken out of scope (e.g., pension plans, some regulated funds, some securitization vehicles and most charities)
- Resident FFIs do not have to enforce FATCA by withholding on downstream non-compliant entities and individuals (although they may have to direct upstream withholding agents to do so), they just have to report on the accounts held by non-compliant and "recalcitrant" account holders.
- FFIs in the partner country do not need to enter into individual FFI Agreements with the IRS or report account holder information directly to the IRS (unless they are in a Model 2 IGA jurisdiction).
- For reciprocal IGAs, the U.S. promises to implement reporting on tax residents of the IGA partner.

In 2012, France, Germany, Italy, Spain and the United Kingdom worked with the U.S. Treasury to develop a Model 1 agreement that would implement the information reporting and withholding tax provisions of FATCA. As outlined in the sidebar on the next page, under a Model 1, FFIs report certain financial account information to their respective taxing authorities, followed by automatic exchange of such information under existing bilateral tax treaties or Tax Information Exchange Agreements (TIEAs). The Model 1 IGA can be reciprocal or non-reciprocal, but the reciprocal version is only available to countries with whom the U.S. has an income tax treaty or TIEA already in place (see page 10 of this paper for more on TIEAs). Furthermore, the recipient government must have in place robust protections and practices (as determined by the U.S. on a case by case basis) to ensure that the information exchanged remains confidential and is used solely for tax purposes.

An additional Model 2 agreement was created in consultation with Switzerland and Japan. Under Model 2, FFIs in participating countries report financial information directly to the U.S. IRS. Thus far, only Switzerland, Japan, Chile, Austria and Bermuda have signed up for this Model.

IRS Revenue Procedure 2014-13 was published on December 26, 2013 to guide and give additional flexibility to FFIs who have to report directly to the IRS on their U.S.-owned accounts. It allows banks and other financial entities in Model 2 IGA jurisdictions to choose whether to apply the due diligence procedures under the IGA or under the FFI agreement. Additional regulations were issued in February which amend and clarify the final regulations issued in January 2013. For example, the definitions of FFIs and Nonfinancial Foreign Entities (NFFEs) have been refined, while the definition of Deemed Compliant FFIs has been clarified.

FFIs subject to FATCA are generally required to register online with the IRS for a Global Intermediary Identification Number (GIIN). FFIs that report under Model 2 agreements will also need to enter into an FFI Agreement with the IRS. Non-

A CLOSER LOOK AT INTERGOVERNMENTAL AGREEMENTS (IGAS)

Model 1A (Most common IGA)
Consider a UK citizen who resides in France, with an account at a New York bank. With the Model 1A Agreement, which has been most popular thus far, the amounts subject to FATCA are reported directly to the French tax authorities rather than the IRS. In this case, the bank would provide France with information on the UK citizen under the TIEA in place between the U.S. and France. All of the model agreements provide that the U.S. will report on residents of the partner country (not citizens) so there will not be any reporting to the UK.

What if a U.S. citizen is resident in the UK and has an account in France? France would provide information to the U.S. on the account in France (and the UK would also provide information to the U.S. on any accounts owned by the U.S. citizen in the UK). The U.S. taxes its citizens on worldwide income regardless of where they reside, while most other countries will tax their residents on worldwide income regardless of where they have citizenship.

Model 1B
The Model 1B Agreement is non-reciprocal. FFIs in the Cayman Islands, for example, will be required to provide certain information about their U.S. account holders to the Cayman Islands Tax Information Authority. The Cayman tax authority in turn will share that information with the IRS using the TIEA in place between Cayman and the U.S.

Alternatively, if a Cayman citizen or resident has an account in the U.S., the IGA does not provide for the automatic exchange of information from the U.S. to Cayman on those citizens or residents. As the Cayman Islands do not levy income or capital gains taxes on its residents, it appears there would be very little fiscal benefit to the Cayman Islands in exchanging information.

Model 2
Under this Model, FFIs must register with the U.S. IRS and report information on U.S. account holders directly to the IRS. There is no reciprocal reporting by the U.S. on residents of these partner countries.

Consider a Swiss citizen with a bank account in the U.S.: Under Model 2, the U.S. will not report any information on Swiss residents with U.S. bank accounts to Switzerland.

If a U.S. citizen has a bank account in Switzerland, a Swiss bank is required to register with the IRS and must report certain information on U.S.-owned accounts to the IRS.

Please visit the U.S. Treasury site for updates to country IGAs at http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx

reporting FIs are not required to register with the IRS for a GIIN. However, an FFI wishing to elect out of an IGA due to classification as deemed compliant or an exempt beneficial owner may need to complete the Form 8957 through the IRS FATCA portal to opt out.

While it is difficult to find positions of public support for FATCA and the IGA system, the intent behind the IGAs is to mitigate several controversial aspects of FATCA, as outlined below.

- **Violation of data privacy and secrecy laws of sovereign nations:** FATCA provisions dictate reporting that may be in violation of local data protection laws of some countries. The IGA eliminates this concern as the partnering country will effectively agree to draft and implement local laws that will achieve FATCA's objectives. It is unlikely that FATCA would have been successful without the cooperation of these partnering countries in entering into IGAs. In fact, the U.S. Treasury stated in the Fiscal Year 2014 Budget request that "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 US 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."
- **Costly extraterritorial reaching by the U.S.:** FATCA enables U.S. authorities to impose regulatory costs and penalties on FFIs that may or may not have U.S. clients. FATCA also imposes data collection norms that can be expensive to implement. Studies have estimated the cost of compliance with FATCA at $30 million to $80 million per bank and millions already have been spent lobbying against the law. Citizens of other countries have vocalized their outrage at perceived gross violations of sovereignty of their home countries as well as violations of the rights of their citizens and residents (For example, see Letter to Canadian Bankers Association from Canadians who are active participants in the Isaac Brock Society and Maple Sandbox blogs). The IGA system is intended to mitigate some of the costs that would be imposed on FFIs if they were required to report under FATCA, which has more onerous identification and documentation standards. However, IGA partner countries will now have increased administrative costs in carrying out their own FATCA-style legislation.

Although countries such as Switzerland have signed a Model 2 IGA, the agreements may still be subject to parliamentary approval. While the Swiss Bankers Association welcomed the signing of the agreement as it would greatly reduce the complexity and cost to Swiss intermediaries arising from the "unilateral" FATCA legislation, it nevertheless stated it continues to view FATCA critically due to the cost and administrative burden it creates. The group felt that if Switzerland refused to implement FATCA, it would face competitive disadvantages internationally that would jeopardize the country's survival.

It was not clear what would happen if a country had not finalized an IGA by mid-June when FATCA withholding went into effect. FFIs in those jurisdictions faced uncertainty as to their status vis a vis FATCA or the IGA. To address this concern, the IRS recently issued Announcement 2014-17 which allows jurisdictions who have "reached an agreement in substance on the terms of an IGA" before July 1, 2014 to be treated as if they were in effect on April 2 (the date of the Announcement). This allows FFIs in those jurisdictions to register on the FATCA registration website and certify their status to a withholding agent as if they were domiciled in a jurisdiction with a signed IGA.

In addition to IGAs, which will automatically report information to specific countries on their residents, there is other FATCA-style legislation coming out of the OECD, the EU and other bilateral treaty discussions. This is further highlighted by the focus of the Group of Eight (G8) Heads of State Summit which took place in June 2013, in which the key themes were tax evasion and transparency.

Countries outside of FATCA and IGA: Tax Havens No More?

As the U.S. has introduced and expanded its information gathering on accounts of U.S. citizens located abroad, other countries have also begun to inquire about their citizens' accounts in other countries on a more formal basis. In addition, jurisdictions that formerly offered non-U.S. persons a haven from their home locales are no longer as attractive as they once were. While these jurisdictions are attempting to shed their reputations as havens for tax cheats, they are also trying to find ways not to lose their important foreign clients.

Many of these foreign havens have well-developed financial systems and experienced multilingual investment managers. Sharing of information on bank and investment accounts of non-residents has become quite commonplace, even in jurisdictions once known for their secrecy. For example, Austria and Luxembourg have agreed to provide data on bank accounts for individuals as well as for trusts and foundations. Cayman Islands and Turks and Caicos Islands announced in May 2013 that they will share bank account information with other countries. By contrast, jurisdictions such as Andorra, Monaco and San Marino have not indicated an interest in more openness. Whether this will give them a competitive advantage over other countries remains to be seen.

Tax Information Exchange Agreements (TIEA) on the Rise

One of the important areas of development in international transparency of financial information is the automatic exchange of information, commonly known as Tax Information Exchange Agreements (TIEAs). This system provides for the periodic and systematic transmission of "bulk" taxpayer information. The exchange occurs between the source country of the financial account and the residence country of the taxpayer and is designed to provide the residence country with sufficient information to assist that country in supporting its revenue laws.

The OECD was a pioneer in establishing this system and developing its technical standards and legal concepts as a baseline through a working group comprising members of OECD and representatives from such jurisdictions as Bahrain, Cayman Islands, Mauritius and the Seychelles. The working group has established technical systems that enable standardization of the format so that the residence country has the ability to capture the necessary information on dividends, interest, pensions, royalties, etc. in a cost effective manner.

The OECD Agreement, which was released in 2002, is not binding but contains two models for bilateral agreements to be adopted by countries interested in having a formal system. Jurisdictions as diverse as the Faroe Islands and Guatemala have entered into such an agreement. In 2013, the OECD and the Council of Europe revised the Convention on Mutual Administrative Assistance in Tax Matters (Multilateral

Convention) which establishes a basis for automatic exchange. Over 60 countries have either signed the Convention or a letter of intent to do so. As more countries adhere to the Convention, developing countries will benefit from it without having to incur what are often significant costs in negotiating bilateral agreements. Countries such as Argentina, China, Costa Rica and Mexico have signed the Convention and Brazil and Colombia are in the process of ratification as of August 2013. This process is ongoing and likely to have new forms as experience provides guidance.

Policy makers across Europe have responded with their support. In April 2013, the G20 Finance Ministers and Central Bank Governors endorsed automatic exchange as the new standard. Then in June 2013, the OECD reported to the G8 Summit about the importance of delivering a standardized model of automatic exchange. The development of a common reporting system, such as the automatic exchange of information, will not only reduce duplication of efforts by the governments of various countries to enforce their tax laws, but will assist financial institutions in providing a standard framework for their obligations of reporting.

The OECD has also released various reports assessing the tax systems of a number of countries dealing with information exchange. It is in the process of reviewing approximately 98 jurisdictions and will release reports periodically assessing their compliance with the individual elements of the international standard for exchange of information and an overall rating which will be one of "compliant," "largely compliant," "partially compliant," or "non-compliant." In December 2013, the British Virgin Islands, Cyprus, Luxembourg and the Seychelles were deemed by the Global Forum to be non-compliant. Switzerland was on a special list where it could not be rated until it relaxed its secrecy laws further. This will hopefully induce more jurisdictions to co-operate effectively in tax information exchange.

There are three key elements in the area of exchange of information: ownership, accounting and bank information. In peer reviews that are being conducted by the OECD, these three elements play an important part of assessing each jurisdiction's level of compliance with international standards. Phase 1 of this review covers the regulatory set-up in each jurisdiction. Phase 2 of the review reports on the implementation of the standards in actual practice in the relevant jurisdiction. There are variations from jurisdiction to jurisdiction. For example, in a recent peer review of Austria, the review reported that Austria was deficient on some aspects of the banking area but had made significant progress on ownership and accounting issues. In the case of Luxembourg, the review stated that while it is generally timely in providing requested information, it fell short in several instances in providing requested information.

While countries are entering into a number of different automatic exchange agreements, whether a TIEA or the Multilateral Convention, taxpayers have been known to challenge these agreements. In a case before the Royal Court of Jersey in the Channel Islands in mid-2013, a Norwegian taxpayer who was given notice of such a request by his home government lost his case to bar the release of information pertaining to him. In this case, it was the financial institution that had been served with the notice that initiated the appeal from the notice. The notice not only applied to the Norwegian citizen's individual information but also to certain companies in which he was believed to have an interest.[23]

New Reporting Laws in Europe

The European Union Savings Directive issued in 2005 obligates financial institutions in European Union member states to issue reports of interest payments made to residents of other member states for the purpose of having these payments subject to tax in that jurisdiction. The EU in November 2013 announced that it is preparing an amendment to the Savings Directive to extend its provisions to cover interest payments passed through trusts and foundations as well as income which may be deemed equivalent to interest obtained through pension, life insurance policies and novel financial investments.

Various countries, other than just the U.S., maintain lists of nations that don't comply with their regulations on tax and/or financial disclosure (variously referred to as white lists, black lists, etc.) A recent example of how this can affect a jurisdiction's legal system is the Isle of Jersey's reducing its time to respond to a disclosure notice under its TIEA rules from 30 days to 15 days, all purportedly to get itself off France's blacklist.[24]

Meanwhile, various countries are enacting laws to track the wealth of their citizens through various registries and other filings. These new laws often provide for severe financial and non-financial penalties for failure to comply. Much of this area is in flux as these governments try to find ways to enforce their new and unaccustomed laws.

France's Parliament has enacted a new public registry of trusts. This registry contains the identity of each settlor, beneficiary and trustee and the trust's enactment date. In addition, it contains new regulations dealing with a variety of acts considered fraudulent or related to money laundering. One of its provisions directs that persons found guilty of using bank accounts or entities held abroad or fictitious or artificial entities which engage in tax fraud are liable to a fine of €2 million euros and seven years of imprisonment. In addition, this act creates a new governmental department to administer the law.[25]

The People's Republic of China has recently created a new governmental agency to supervise compliance with new financial laws they enact to govern foreign financial accounts and economic transactions which are deemed cross-border (just like France). This new law requires Chinese citizens and foreign persons within its borders to report to this agency their foreign financial assets and liabilities as well as cross border transactions. The law applies to individuals as well as institutions.

Conclusion: Nowhere to Hide

There is no question that the U.S. is aggressively pursuing undeclared offshore accounts. The long arm of the U.S. government has even extended to financial institutions in other countries. In early 2013, Wegelin & Co., Switzerland's oldest bank, pled guilty to aiding U.S. persons in hiding more than $1.2 billion offshore. The storied Swiss bank subsequently closed its doors. Since then, under the protection of the Swiss government, Swiss banks are cooperating with the U.S. government in releasing information about its U.S. clients.

Ironically, FATCA may also have the unforeseen effect of calling attention to America's own transgressions in helping global investors avoid paying taxes in their home countries. The Tax Justice Network, a non-profit, U.K.-based organization that campaigns for transparency and disclosure by international financial services, has called the U.S. "the world's biggest offshore banking destination." The group estimates that non-resident aliens in the U.S. have more than $3 trillion in U.S. accounts. Furthermore, the U.S. ranked sixth in the Financial Secrecy Index, which was created in 2013 by TJN to measure the secrecy level of countries around the world.

With IGAs in negotiation or completed in over 70 countries, and many being reciprocal, the U.S. will lose much of the veil of secrecy it has thus far enjoyed in attracting foreign citizen investment. In addition, as a party to most of the IGAs negotiated, the U.S. government (and by extension, U.S. financial institutions) will bear the brunt of the complexity and expense of providing reciprocal reporting that is increased pursuant to these IGAs.

According to repealfatca.com, at least 30 IGAs are needed to consider FATCA a success and along the road to raise the expected $800 million of tax revenue forecast by the Association of Certified Financial Crime Specialists. With close to that amount now signed and even more now deemed to be "agreements in substance" it appears as if the world is well on its way down the road to achieve global transparency.

The New Global Landscape

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[9] *U.S. v. Simon, 11-1837(7th Cir 2013).*
[10] *Although the Q & A to the OVDP states that compliance under the program will "generally eliminate the risk of criminal prosecution", and that "the IRS will not recommend criminal prosecution to the Department of Justice" [SOURCE: http://www.irs.gov/uac/2009-Offshore-Voluntary-Disclosure-Program], there is no guarantee that participation in the OVDP will insulate a taxpayer from criminal prosecution. Recently, the U. S. government argued that in fact civil relief by another government agency does not prevent the Department of Justice from a criminal prosecution [U. S. v. Simon, 11-1837 (7th Cir 2013)].*
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