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Lawrence A. Kogan on

U.S. FATCA Information Reporting: A Pretext for Fishing With Like-Minded European and OECD Nations For Long Forsaken Tax Revenues at Exotic Offshore Locations

2012 Emeraina Issues 6831

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FATCA's Objective

The Foreign Account Tax Compliance Act ("FATCA"), which added new Chapter 4 to Subtitle A of the Internal Revenue Code (comprising Sections 1471 through 1474) was signed into law on March 18, 2010 by President Obama as part of the Hiring Incentives to Restore Employment Act of 2010, P.L. 11-147. FATCA's objective is to help "plug" the portion of the federal tax gap (estimated to be \$345 billion in 2001¹ and \$385 billion in 2006)² that is attributable to US taxpayers' failure to voluntarily report³ and pay taxes⁴ on earnings they derived directly and indirectly from a large variety of investment-based assets held in offshore accounts.⁵ Congressional and Treasury Department investigations have estimated that US individual (citizen and resident) and corporate taxpayers, with professional⁶ and foreign banking⁷ assistance, have successfully

¹ See United States Department of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance*, (July 8, 2009) at p. 2, accessible at: http://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf.

² See Internal Revenue Service, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, Information Release (IR-2012-4, Jan. 6, 2012), accessible at: <http://www.irs.gov/uac/IRS-Releases-New-Tax-Gap-Estimates-Compliance-Rates-Remain-Statistically-Unchanged-From-Previous-Study>.

³ Cf. U.S. Department of Treasury, *Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA (2/7/12)* at par. 4, accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf> ("Because the policy objective of FATCA is to achieve reporting, not to collect withholding tax, the United States is open to adopting an intergovernmental approach to implement FATCA and improve international tax compliance").

⁴ "The tax gap is defined as the amount of tax liability faced by taxpayers that is not paid on time." See Internal Revenue Service, *The Tax Gap*, accessible at: <http://www.irs.gov/uac/The-Tax-Gap>.

⁵ "U.S. investments...[may be held in...] any variety—from U.S. treasuries to U.S. stocks and bonds to debt and equity interests in U.S. businesses...[The accounts covered include]...not only traditional savings, checking, and securities accounts, but also debt and equity interests in hedge funds, private equity funds, and other types of investment firms." See 156 CONG. REC. S1745 (March 18, 2010) (quoting Subcommittee Chair, Representative Carl Levin), accessible at: <http://www.gpo.gov/fdsys/pkg/CREC-2010-03-18/pdf/CREC-2010-03-18-pt1-PgS1745.pdf>.

⁶ See United States Senate PERMANENT SUBCOMMITTEE ON INVESTIGATIONS Committee on Homeland Security and Governmental Affairs, *Tax Haven Abuses: The Enablers, The Tools And The Secrecy*, Minority and Majority Staff Report Released in Conjunction with the Permanent Subcommittee on Investigations August 1, 2006 Hearing at p. 2, accessible at: <http://www.hsgac.senate.gov/subcommittees/investigations/hearings/tax-haven-abuses-the-enablers-the-tools-and-secrecy>. The Senate investigation revealed that offshore tax evasion was accomplished with professional advice that sanctioned use of various tools, including phony loans, billing schemes and offshore credit cards, use of intermediaries to disguise foreign corporate ownership, complex securities transactions that worked in concert with bank secrecy laws to shelter capital gains, and multiple offshore corporate and trust vehicles to exercise indirect control over income-earning and gain-producing assets. *Id.*, at pp. 2-3.

⁷ See United States Senate PERMANENT SUBCOMMITTEE ON INVESTIGATIONS Committee on Homeland Security and Governmental Affairs, *Tax Haven Banks and U.S. Tax Compliance*, Staff Report Released in Conjunction with the Permanent

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evaded payment of approximately \$100 billion in US federal taxes each year, “represent[ing] a substantial portion of the annual U.S. tax gap”.⁸

Several studies have revealed that the federal tax gap surrounding offshore accounts was exacerbated, in part, by the information self-reporting systems in place prior to FATCA’s enactment, including the Report of Foreign Bank and Financial Accounts (FBAR) enacted under the U.S. Bank Secrecy Act and the Qualified Intermediary (QI) program enacted under Subchapter 3 of the Internal Revenue Code ([IRC Section 1441](#)). The FBAR, which is filed separately from the US tax return, was intended as a self-reporting system to track foreign bank accounts with balances exceeding \$10,000.⁹ The FBAR rules required U.S. citizens and residents to maintain records and report the identities and relationships of parties participating in a transaction with a foreign financial entity serving as the agent of another.¹⁰ However, bank secrecy laws¹¹ often encouraged U.S. taxpayers to shirk their FBAR filing responsibilities¹² and such noncompliance went largely unpunished.¹³ The QI cross-border reporting program was originally envisioned as “a paradigm shift to greater self-regulation” that relied largely

Subcommittee on Investigations JULY 17, 2008 Hearing, accessible at:

<http://www.levin.senate.gov/imo/media/doc/supporting/2008/071708PSIReport.pdf>. This Senate investigation revealed that various foreign banks, including UBS AG in Switzerland and LGT Bank in Liechtenstein, facilitated US tax evasion by helping “clients to open accounts in the names of offshore entities; advising clients on complex offshore structures to hide ownership of assets; using client code names; and disguising asset transfers into and from accounts.” *Id.*, at p. 16.

⁸ *Id.*, at pp. 1, 17, fns 1, 17, referencing various expert sources. “The HIRE Act is a significant victory for law-abiding U.S. taxpayers, and a significant blow against those who dodge their responsibilities. The Permanent Subcommittee on Investigations...has spent years investigating offshore tax abuses which together cost the federal treasury an estimated \$100 billion in lost tax revenues annually.” See 156 CONG. REC. S1745, *supra*.

⁹ See [31 C.F.R. §§ 103.24–27](#) (2010); [31 C.F.R. § 103.27\(c\)](#).

¹⁰ See [31 U.S.C. § 5314\(a\)](#) (2006) and [31 USC 5312\(a\)\(1\)-\(2\)](#) (requiring US citizens and residents to maintain records and report the identities and relationships of parties participating in a transaction with a foreign financial entity serving as the agent of another).

¹¹ “The FBAR penalties arise under Title 31 of the United States Code and are not generally within the scope of the taxes covered by the tax treaties. As a result, the treaty secrecy clause prevents sharing the information with those who investigate FBAR penalties...Even if the penalties are covered by the treaty, domestic legislation could prevent use of the information.” See Staff of Joint Committee on Taxation, *Tax Compliance and Enforcement Issues With Respect to Offshore Accounts and Entities*, Scheduled for a Public Hearing Before the SUBCOMMITTEE ON SELECT REVENUE MEASURES of the HOUSE COMMITTEE ON WAYS AND MEANS on March 31, 2009 (JCX-23-09 March 30, 2009), at p. 60, accessible at: <https://www.jct.gov/publications.html?func=startdown&id=3520>

¹² For example, “The U.S. clients...[of Liechtenstein Global Trust Group (‘LGT’)]...typically did not file the FBAR form to disclose the existence of [trust] accounts to the Treasury Department, apparently taking the position that only the nominal owner of the accounts were required to file.” *Id.*, at p. 41.

¹³ For example, the IRS’ 2003 Offshore Voluntary Compliance Initiative “waived the civil fraud penalty and certain penalties relating to failure to file information and other returns, including the Report of Foreign Bank and Financial Accounts (‘FBAR’).” *Id.*, at p. 49, referencing News Release, Internal Revenue Service, IR-2003-48 (April 10, 2003) (“The FBAR penalty will be waived for taxpayers who participate in OVCI.”), accessible at: <http://www.irs.gov/pub/irs-news/ir-03-48.pdf>.

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upon “know-your-customer rules”.¹⁴ The QI program targeted non-U.S. persons holding U.S. portfolio investments to ensure that they paid tax on the income those investments earned. The QI program was based on a voluntary agreement reached between the IRS and a foreign financial institution. In exchange for identifying and reporting account owners’ identities, and calculating and withholding taxes on U.S. source income paid to offshore payees,¹⁵ QIs were permitted “to certify on behalf of their foreign customers, without revealing to the IRS or to other U.S. withholding agents the identity of those foreign customers.”¹⁶ In other words, due to bank secrecy rules, QIs frequently failed or were unable to identify jurisdictions or recipients which resulted in the substantial under-withholding of tax.¹⁷

The FATCA framework is intended to reduce the degree of foreign underreporting, underpayment and non-filing¹⁸ that gave rise to the offshore portion of the federal tax gap. It aims to achieve this by requiring foreign financial conduits to establish tiered reporting and payment systems that trace for the IRS U.S. source cross-border portfolio income remittances to individual offshore financial accounts directly or beneficially held

¹⁴ See Staff of Joint Committee on Taxation, *Tax Compliance and Enforcement Issues With Respect to Offshore Accounts and Entities*, supra at p. 22, referencing IRS [Announcement 2000-48](http://www.irs.gov/pub/irs-drop/a-00-48.pdf), 2000-1 C.B. 1243, accessible at: <http://www.irs.gov/pub/irs-drop/a-00-48.pdf>.

¹⁵ See United States Government Accountability Office, *Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved*, Report to the Committee on Finance, U.S. Senate (GAO-08-99) (Dec. 2007) at GAO Summary Findings, pp. 10, 12, accessible at: <http://www.gao.gov/assets/280/270588.pdf>. FFIs identified and collected information on non-US persons and determined whether such persons, based on their country of residence and income type, were entitled to (eligible for) a reduced withholding tax rate available under a tax treaty or a U.S. statutory rule.

¹⁶ See Staff of Joint Committee on Taxation, *Tax Compliance and Enforcement Issues With Respect to Offshore Accounts and Entities*, supra at p. 22. According to at least one commentator, “The QI rules were of particular importance to private banks engaged in asset management, because a QI was able to conceal the identity of its non-U.S. customers from both competitor institutions and the IRS. As a result, a QI could ensure that other financial institutions in the chain of intermediation would not be able to steal its customers, and could assure its customers that the IRS would not provide information to their customer’s home country tax authority.” See Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System*, Working Draft, Georgetown Law Faculty Working Papers, Paper No. 160, Jan. 27, 2012), at p. 16, accessible at: http://scholarship.law.georgetown.edu/fwps_papers/160; http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1162&context=fwps_papers. See also OECD, *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors*, OECD (Jan. 12, 2009), at par. 18, accessible at <http://www.oecd.org/dataoecd/34/19/41974569.pdf> (“From a business perspective, one of the major benefits of these systems is that information regarding the beneficial owner of the income is maintained by the intermediary at the bottom of the chain, rather than being passed up the chain of intermediaries. Accordingly, intermediaries in the chain can facilitate treaty claims for their customers, without passing proprietary customer information to potential competitors (i.e. the other intermediaries).”).

¹⁷ See United States Government Accountability Office, *Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved*, supra, at pp. 2, 4, 11, 13.

¹⁸ The federal tax gap has been described as being comprised of three components – underreporting, underpayment and non-filing – with underreporting being the single largest contributing factor. See Internal Revenue Service, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged From Previous Study*, supra; United States Department of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance*, supra at p. 2.

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by US persons. Through improved reporting¹⁹ the IRS hopes to identify and recover specific revenue items that would otherwise be properly taxable and collectible if they had been properly disclosed.

FATCA's emphasis on transparency builds upon Treasury Department findings that "compliance is highest where parties other than the taxpayer are required to file information reports and withhold taxes from payments made."²⁰ For example, to facilitate greater transparency, the IRS has clarified that mandatory FATCA foreign financial institution ("FFI") reporting obligations apply in addition to those imposed under [IRC Section 1441](#) in connection with the QI program²¹ as well as those imposed on both US and foreign financial institutions under [IRC Section 6049](#) with respect to accounts held by nonresident aliens.²² The IRS has also clarified that FATCA taxpayer reporting obligations imposed under new Section 6038D²³ apply in addition to those imposed on account holders under the FBAR rules.²⁴

FACTA's Antecedents

Furthermore, FATCA is largely premised on and expands upon the practices of other (taxpayer residence) countries which require third-party payors located in third countries (income source countries) to report certain income items paid to their nationals (citizens

¹⁹ See [26 USC 1471](#)(c)(1).

²⁰ See United States Department of the Treasury, *Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance*, supra at p. 6. See also Prop. Reg. 1.1471-1 Section II, p. 4 (referring to the common purpose of FATCA and Subchapter 3 reporting and withholding rules - to "assist[] taxpayers in correctly computing and reporting their tax liabilities, increase[] compliance with tax obligations, reduce[] the incidence of and opportunities for tax evasion, and thus...help[] to maintain the fairness of the U.S. federal income tax system.").

²¹ See 26 USC 1471(c)(3). Notwithstanding these potentially duplicative reporting obligations, the FATCA proposed regulations ensure coordination between FATCA's withholding provision and those of Subchapter 3 of the Internal Revenue Code (Sections 1441-1443, 1445) in order to prevent over-withholding. See Prop. Reg. Sec. 1.1474-6.

²² See [26 USC 6049](#)(b)(5)(A) (relating to amounts subject to withholding under subchapter A of chapter 3 – i.e., concerning withholding of tax on nonresident aliens and foreign corporations); Prop. Reg. Section §1.6049-4(b)(5), [TD 9584](#) (Payors of interest aggregating \$10 or more to nonresident alien individuals must "make an information return on Form 1042-S, 'Foreign Person's U.S. Source Income Subject to Withholding'").

²³ See [26 USC 6038D](#) ("requiring individuals to file a statement with their income tax returns to report interests in specified foreign financial assets if the aggregate value of those assets exceeds certain thresholds"). See Internal Revenue Service, *Explanation of Section 6038D Temporary and Proposed Regulations*, accessible at: <http://www.irs.gov/Businesses/Corporations/Explanation-of-Section-6038D-Temporary-and-Proposed-Regulations>; [Rev. Proc. 2012-24](#) - *Implementation of Nonresident Alien Deposit Interest Regulations*, accessible at: <http://www.irs.gov/pub/irs-drop/rp-12-24.pdf>.

²⁴ The IRS has emphasized that taxpayers must file Form 8938 in addition to FBAR Form TD F 90-22.1 if applicable. See Internal Revenue Service, *Instructions to IRS Form 8938 - Statement of Specified Foreign Financial Assets* (Nov. 2011), accessible at: <http://www.irs.gov/pub/irs-pdf/i8938.pdf>; Internal Revenue Service, *Foreign Account Tax Compliance Act (FATCA): Comparison of Form 8938 and FBAR Requirements*, accessible at: [http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-\(FATCA\)](http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)) and <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>. See also Draft IRS Form 8938 (Nov. 2012), accessible at: <http://www.irs.gov/pub/irs-dft/i8938--dft.pdf>.

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and residents).²⁵ One such initiative, the European Union Savings Directive (“EUSD”) (Council Directive 2003/48/EC)²⁶, was narrowly focused on interest payments.²⁷ Its ultimate objective was to “enable savings income in the form of interest payments made in one [EU] Member State to beneficial owners who are individuals resident in another [EU] Member State to be made subject to effective taxation in accordance with the laws of the latter [residence] Member State.”²⁸ The EUSD required the competent authorities of EU source countries (from which interest was paid) to automatically exchange information with one another, and if they chose not to do so, they were required to ensure that up to a 35% tax was withheld from such payments.²⁹ Moreover, due to the concern that capital flight to non-EU jurisdictions which did not apply EUSD-consistent measures would undermine the Directive’s objective,³⁰ the EU entered into a series of bilateral automatic information exchange agreements with non-EU nations that provided, at a minimum, for the adoption of the EUSD’s withholding tax system.³¹

FATCA is also based partially on recent multilateral taxpayer information exchange initiatives at the Organization for Economic Cooperation and Development (“OECD”) designed to correct the perceived ineffectiveness of the OECD’s 2002 Model

²⁵ “[A]s is the case in many countries, third-party payors of certain items are required to report these amounts to the IRS. Such reporting serves as an important and long-standing check on voluntary compliance.” See Prop. Reg. Sec. 1.1471-1, Section I at p. 3.

²⁶ See COUNCIL DIRECTIVE 2003/48/EC (June 3, 2003) *On Taxation of Savings Income in the Form of Interest Payments*, (O.J. L 157/38 June 26, 2003), accessible at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:en:PDF>. “The ultimate aim of this Directive is to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State.”

²⁷ “The Directive has a relatively broad scope (article 6) that covers interest from debt-claims of every kind whether obtained directly or as a result of indirect investment via most collective investment undertakings and via other residual entities (paying agents upon receipt).” See European Commission, Taxation and Customs Union, *Rules Applicable to Taxation of Savings*, accessible at: http://ec.europa.eu/taxation_customs/taxation/personal_tax/savings_tax/rules_applicable/index_en.htm.

²⁸ *Id.*, Preamble, par. 8, Article 1.1.

²⁹ *Id.*, Preamble pars. 14, 16-17. See also Articles 9, 11. Most EU Member States adopted exchange-of-information legislation to implement said directive, except bank secrecy jurisdictions Belgium, Luxembourg and Austria, which were permitted to and did adopt a withholding tax system. *Id.*, Article 10.1. Also, “the dependent or associated territories of the UK and the Netherlands (including the Channel Islands and various Caribbean islands) that did not agree to exchange information automatically [were] required to participate in the EUSD as withholding jurisdictions and to move to automatic information exchange at such time as the transitional period ends.” See Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System*, supra at p. 20, fn74. See also COUNCIL DIRECTIVE 2003/48/EC supra, Article 17.2(ii).

³⁰ See COUNCIL DIRECTIVE 2003/48/EC supra, Preamble par. 24 and Article 17.2(i).

³¹ See Agreement Between the European Community and the Swiss Confederation Providing for Measures Equivalent to Those Laid Down in Council Directive 2003/48/EC on Taxation of Savings Income in the Form of Interest Payments - Memorandum of Understanding, (Oct. 26, 2004, O.J. L385/30), accessible at: [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:22004A1229\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:22004A1229(01):EN:HTML). The EU struck similar agreements with the Principality of Andorra, Liechtenstein and Monaco and the Republic of San Marino. See Europa, Directory of European Legislation in Force Since 12/1/2012 – Chapter 10.40 Free Movement of Capital, accessible at: <http://eur-lex.europa.eu/en/legis/latest/chap1040.htm>.

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Agreement on Information Exchange on Tax Matters (“TIEA”)³² and the 2005 and 2008 updates to the information exchange provisions of the OECD Model Tax Convention on Income and Capital the requirements of which do not appear to be deemed incompatible with bank secrecy.³³ For example, during 2009, an OECD Informal Consultative Group’s (ICG’s) report recommended modifications to the US QI program for purposes of more adequately addressing the role that financial intermediaries should play in treaty relief systems (i.e., for claiming tax treaty benefits). The ICG report made several key recommendations that appear to have ultimately surfaced in FATCA: 1) Intermediaries should report all “[i]nvestor-specific information with respect to treaty-benefitted income and income paid to residents of the source country...[they possess]...to the source countries, which then would provide such information to residence countries under automatic exchange of information programs”;³⁴ 2) Tax treaty relief systems should “allow authorised intermediaries to make claims on behalf of their customers on a ‘pooled’ basis [rather than on a customer-specific basis] at or before the time a payment is made”;³⁵ 3) Intermediary authorizations should “consist of a contract between the intermediary and the relevant source countries, where possible under domestic law”,³⁶ and such contracts should be “standardised across countries to the

³² See Michael J. McIntyre, *How to End the Charade of Information Exchange*, 56 Tax Notes International 255 (Oct. 26, 2009), accessible at: http://faculty.law.wayne.edu/mcintyre/text/mcintyre_articles/Treaties/charade_56TNI.pdf. See also OECD, *Model Agreement on Exchange of Information on Tax Matters* (2002), Articles 5.1, 5.4(a) and 7.1, and accompanying commentary, accessible at: <http://www.oecd.org/ctp/exchangeofinformation/2082215.pdf> (conditioning information exchange upon a competent authority’s request, and providing a basis for the counterparty to decline satisfying that request based upon its inability to obtain the requested information under its own laws for purposes of the administration or enforcement of its own tax laws).

³³ For example Article 26, as updated, precludes Member States from refusing to supply such information solely on bank secrecy grounds. See OECD, *Tax Treaties - Article 26 of the OECD Model Tax Convention on Income and Capital*, accessible at: <http://www.oecd.org/ctp/taxtreaties/article26oftheoecdmodeltaxconventiononincomeandcapital.htm>. See also OECD, *Articles of the Model Convention With Respect to Taxes on Income and on Capital* (July 17, 2008), accessible at: <http://www.oecd.org/ctp/taxtreaties/42219418.pdf>. Article 26.1 “creates an obligation to exchange information that is foreseeably relevant to the correct application of a tax convention as well as for purposes of the administration and enforcement of domestic tax laws of the contracting states.” *Id.* Article 26.3(a)-(b) of the Convention relieves a Contracting Party of the obligation set forth in Article 26.1 to “exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description”, if it would “impose on a Contracting State the obligation: a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State; b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State...” *Id.*

³⁴ See OECD, *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors* supra, Part VI, par. 131. According to two OECD officials, automatic information exchange has several benefits, including: 1) “provid[ing] timely information on non-compliance where tax has been evaded either on investment return or the underlying capital sum”; 2) help[ing] detect cases of non-compliance even where tax administrations have had no previous indications of noncompliance; and 3) providing a) deterrent effect, increasing voluntary compliance and encouraging taxpayers to report all relevant information.” See Achim Pross and Stephanie Smith, *Tax Co-operation: Beyond Exchange of Information on Request*, World Commerce Review (June 2012), accessible at: http://www.worldcommercereview.com/publications/article_pdf/628.

³⁵ *Id.*, Part VI, pars. 129, 133.

³⁶ *Id.*, Part VI, par. 133.

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extent possible”;³⁷ 4) Authorized intermediaries should not be held liable for withholding tax or penalties if they “rely on information received from...customers...or from other intermediaries, whether authorised intermediaries making pooled claims for benefits, or non-authorised intermediaries providing investor information, unless...[they]...know or, based on industry standards, should have known that the information was incorrect”;³⁸ and 5) Governments should “not give up their right to see information held by intermediaries regarding beneficial owners.”³⁹ Overall, the OECD recommended approach provided incentives rather than imposed penalties to encourage FFI participation.⁴⁰

FACTA’s General Framework

Building upon these reference points, FATCA empowers the IRS to unilaterally deputize third party foreign financial institutions (“FFIs”)⁴¹ to serve as the IRS’ extraterritorial information reporting and withholding agents⁴² for purposes of securing essential information about, and potentially collecting long forsaken taxes with respect to, many different types of U.S. source payments destined for the offshore accounts of U.S. individuals and certain U.S. beneficially owned non-financial foreign entities (“NFFEs”).⁴³ The FATCA framework, like the EUSD, presents third party financial

³⁷ *Id.*, Part VI, par. 134. See also OECD, *Possible Improvements to Procedures for Tax Relief for Cross-Border Investors: Implementation Package*, Report by the Pilot Group on Improving Procedures for Tax Relief for Cross-Border Investors, Public Discussion Draft (2/8/10), accessible at: <http://www.oecd.org/ctp/taxtreaties/44556378.pdf>, referencing OECD, *Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-border Investors on Possible Improvements to Procedures for Tax Relief for Cross-Border Investors* supra. “The ICG Report concluded that the most efficient way for the “best practices” to be implemented was through individual source countries entering into contracts with financial intermediaries. Accordingly, the Implementation Package consists of a self-contained set of all of the agreements and forms that would pass between a source country and the financial intermediaries and investors participating in the system.” *Id.*, at pp. 3, 7.

³⁸ *Id.*, Part VI, par. 136.

³⁹ *Id.*, Part VI, par. 137.

⁴⁰ See Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System*, supra at p. 22.

⁴¹ See [26 USC 1471\(d\)\(4\)](#).

⁴² FATCA defines the term ‘withholding agent’ to include “all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment.” See [26 USC 1473\(1\)\(C\)\(4\)](#).

⁴³ FATCA refers to these accounts as ‘United States Accounts’, which are defined as “any financial account which is held by one or more specified United States persons or United States owned foreign entities.” See [26 USC 1471\(d\)\(1\)\(A\)](#). A ‘Specified United States Person’ is defined as including “United States Persons” other than publicly traded corporations, affiliated corporate group members, nonprofit organizations and certain individual retirement accounts, US federal governmental agencies and instrumentalities, US territories, State governments and subdivisions or tax-exempt trusts. See [26 USC 1473\(3\)](#). ‘United States Persons’ include US citizens and residents, domestic partnerships, corporations and estates, and certain domestic and foreign trusts. See [26 USC 7701\(a\)\(30\)](#); Prop. Reg. 1.1471-1(b)(46)(i). A ‘United States-owned Foreign Entity’ is defined as including “any foreign entity which has one or more substantial United States owners.” See [26 USC 1471\(d\)\(3\)](#). A ‘Substantial United States Owner’ is defined as including ‘Specified United States Persons’ holding: a) a greater than 10% direct or indirect stock ownership interest (by vote or value) in a corporation; b) a greater than 10% direct or indirect equity or profits interest in a

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intermediaries with a choice. FFIs, including FFIs serving as intermediaries, can either enter into a disclosure compliance agreement⁴⁴ with the IRS to undertake due diligence necessary and sufficient to secure correct U.S. account and account holder information (based on the “knows or has reason to know” standard),⁴⁵ to file related information reports, to withhold a 30% tax from US source “withholdable payments”⁴⁶ made directly to recalcitrant US account holders⁴⁷ or indirectly to US account holders through⁴⁸ non-deputized⁴⁹ or otherwise uncooperative FFIs or NFFEs,⁵⁰ and to close US accounts in the absence of a waiver providing the FFI a derogation from bank secrecy nondisclosure laws,⁵¹ or they can accept the imposition of a 30% withholding tax upon certain of their own US source income.⁵² Cognizant that local bank secrecy laws can preclude FFIs from entering into such agreements directly with a foreign taxing authority

partnership; and c) any deemed interest in a tax-exempt trust, or a greater than 10% direct or indirect actual beneficial interest in such trust. See 26 USC 1473(2).

44 See 26 USC 1471(b)(1) and (e), 1474(e); Prop. Reg. 1.1471-4. Although the IRS has not yet released an FFI Agreement form, it has solicited public comments for purposes of formulating Draft Form 8957 - *Registration for Participating, Limited, or Registered Deemed Compliant Foreign Financial Institution Status*. See 77 FR 49060 (Aug. 15, 2012), accessible at: <http://www.gpo.gov/fdsys/pkg/FR-2012-08-15/pdf/2012-19972.pdf>.

45 See, e.g., Prop. Reg. Sec. 1.471-2(a)(2)(ii) and (a)(2)(iv) (providing that “A participating FFI that acts as an intermediary or that is a nonwithholding flow-through entity and that provides a valid withholding certificate and all required documentation is not required to withhold or report such payment under chapter 4 unless it knows or has reason to know that the withholding agent failed to withhold the correct amount or failed to report the payment correctly”) (emphasis added). See also Prop. Reg. Sec. 1.471-2(b)(2) (providing that “A withholding agent may rely upon a person’s entity classification contained in a valid Form W-8 or Form W-9 if the withholding agent has no reason to know that the entity classification is incorrect”, and that “A withholding agent that makes a payment with respect to an offshore obligation may also rely upon a written notification provided by the person who receives the payment, regardless of whether such notification is signed, that indicates the person’s entity classification unless the withholding agent has reason to know that the entity classification indicated by the person who receives the payment is incorrect”) (emphasis added). See also Prop. Reg. Sec. 1.471-2(d)(1)-(11) (providing that “A withholding agent may not rely on documentation described in this paragraph (d) if it knows or has reason to know that such documentation is incorrect or unreliable” (emphasis added); Prop. Reg. Sec. 1.471-2(e) (providing “the standards of knowledge for when a withholding agent knows or has reason to know that a withholding certificate is unreliable or incorrect” (emphasis added).

46 FATCA defines the term ‘withholdable payment’ to consist of all US source payments made to US citizens and residents, including payments of US source ‘fixed or determinable, annual or periodical’ (“FDAP”) made to nonresident aliens and foreign corporations that are subject to the more limited withholding rules of Subchapter 3 to Title A of the Internal Revenue Code. Cf. 26 USC 1473(1)(A) to 26 USC 1441-1442.

47 A ‘Recalcitrant Account Holder’ is defined as an account holder who fails to comply with reasonable information requests or fails to provide a valid and effective waiver holding the FFI harmless for disclosing US account holder information in contravention of local bank secrecy laws. See 26 USC 1471(d)(6).

48 FATCA refers to these types of payments ‘pass-thru payments’, which are defined as “any withholdable payment or other payment to the extent attributable to a withholdable payment.” See 26 USC 1471(d)(7).

49 These are properly referred to as ‘nonparticipating FFIs’ and ‘nonparticipating NFFEs’.

50 See 26 USC 1471(b)(1)(A)-(F). A ‘Participating FFI’ is an FFI that enters into an agreement with the IRS to: a) undertake due diligence and obtain information sufficient to discern/identify which of its accounts are US accounts or any additional information the US Treasury Secretary requests; b) undertake annual reporting with respect to such accounts; c) withhold a 30% tax on any pass-thru payments made to recalcitrant US account holders, to non-participating FFIs, or to FFI’s that have elected to fall subject to a 30% withholding regime in lieu of disclosing their US account holder information; and d) secure a valid and effective waiver holding the FFI harmless for disclosing US account holder information in contravention of local bank secrecy laws.

51 See 26 USC 1471(a), (b)(3); 26 USC 1471(d)(6).

52 See 156 CONG. REC. S1745, *supra*. See also 26 USC 1471(a), (b)(3).

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(e.g., the Treasury Department), the United States and several European countries announced upon the release of proposed FATCA regulations that they would pursue an intergovernmental approach to FATCA implementation.⁵³ As a result, FATCA now permits FFIs to submit such information indirectly to the IRS vis-à-vis their own government's competent tax authority in accordance with the terms of one of several Treasury Department intergovernmental (bilateral) FACTA-related taxpayer information exchange agreements.⁵⁴ Additionally, and for the purpose of helping the Treasury Department to gain leverage in treaty negotiations, FATCA requires USFIs to gather and report information about nonresident-held US deposit interest accounts and to engage in backup withholding in the absence of such reporting.⁵⁵ Despite the apparent success of this intergovernmental program as may be inferred from the many bilateral negotiations under way⁵⁶ and the growing number of bilateral agreements being

⁵³ See U.S. Department of Treasury, *Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA* supra, at par. 3. The Joint Statement was released on February 7, 2012, while the IRS released Proposed Regulations for implementing FATCA on February 8, 2012. See Internal Revenue Service, *Treasury, IRS Issue Proposed Regulations for FATCA Implementation* (IR-2012-15, Feb. 8, 2012), accessible at: <http://www.irs.gov/uac/Treasury-IRS-Issue-Proposed-Regulations-for-FATCA-Implementation>.

⁵⁴ See, e.g., Internal Revenue Service [Announcement 2012-42](http://www.irs.gov/pub/irs-drop/A-12-42.pdf) (Oct. 24, 2012) - *Timelines for Due Diligence and Other Requirements under FATCA* at pp. 1-2, accessible at: <http://www.irs.gov/pub/irs-drop/A-12-42.pdf>. On July 25, 2012, the Treasury Department released the *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA (Model 1)* "under which FFIs would satisfy their chapter 4 requirements by reporting information about U.S. accounts to their respective tax authorities, followed by the automatic exchange of that information on a government-to-government basis with the United States." See [Announcement 2012-42](http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1A-Agreement-to-Implement-Reciprocal-11-14-2012.pdf), supra at p. 1. This agreement comes in two forms 'reciprocal' and 'nonreciprocal'. The reciprocal form requires the US to provide certain information on local accounts held by residents of the FATCA partner party, whereas, the nonreciprocal form obliges only the FATCA party to provide information on local accounts held by US residents. See Internal Revenue Service, *Reciprocal Version of Model Agreement (Model 1A)*, accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1A-Agreement-to-Implement-Reciprocal-11-14-2012.pdf>; Internal Revenue Service, *Nonreciprocal Version of Model Agreement (Model 1B)*, accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1B-Agreement-to-Implement-Nonreciprocal-11-14-2012.pdf>. On November 14, 2012, Treasury published the *Model Intergovernmental Agreement for Cooperation to Facilitate the Implementation of FATCA (Model 2)* "under which financial institutions in the partner jurisdiction would report specified information directly to the IRS in a manner consistent with the FATCA regulations, supplemented by government-to-government exchange of information on request." See [Announcement 2012-42](http://www.irs.gov/pub/irs-drop/A-12-42.pdf), supra at pp. 1-2.

⁵⁵ See [26 USC 6049](http://www.irs.gov/pub/irs-drop/A-12-42.pdf) and accompanying regulations. According to the Treasury Department, "A jurisdiction's willingness to share information with the IRS to combat offshore tax evasion by U.S. taxpayers depends, in large part, on the ability of the IRS to exchange information that will assist that jurisdiction in combating offshore tax evasion by its own residents. These regulations, by requiring reporting of deposit interest to the IRS, will ensure that the IRS is in a position to exchange such information reciprocally with a treaty partner when it is appropriate to do so... In many cases...the implementation of FATCA will require the cooperation of foreign governments in order to overcome legal impediments to reporting by their resident financial institutions. Like the United States, those foreign governments are keenly interested in addressing offshore tax evasion by their own residents and need tax information from other jurisdictions, including the United States, to support their efforts. These regulations will facilitate intergovernmental cooperation on FATCA implementation by better enabling the IRS, in appropriate circumstances, to reciprocate by exchanging information with foreign governments for tax administration purposes." See [T.D. 9584](http://www.irs.gov/irb/2012-20_IRB/ar07.html), *Guidance on Reporting Interest Paid to Nonresident Aliens - Final Regulations* (IRB 2012-20) (May 14, 2012), at p. 900, *Explanation and Summary of Comments, Objectives of This Regulatory Action* accessible at: http://www.irs.gov/irb/2012-20_IRB/ar07.html; [77 FR 23391](http://www.gpo.gov/fdsys/pkg/FR-2012-04-19/pdf/2012-9520.pdf) (April 19, 2012), accessible at: <http://www.gpo.gov/fdsys/pkg/FR-2012-04-19/pdf/2012-9520.pdf>.

⁵⁶ On November 8, 2012, the Treasury Department announced that "it [was] engaged with more than 50 countries and jurisdictions around the world to improve international tax compliance and implement the information reporting and withholding tax provisions

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executed (with the UK, Denmark, Mexico, Spain and Switzerland),⁵⁷ it would not be inaccurate to conclude that industry, which ordinarily applauds international standards that can reduce cross-border transaction costs, has become somewhat disenfranchised by it.⁵⁸

FATCA's Progeny

Following FATCA's enactment, on February 15, 2011, the EU adopted Council Directive 2011/16/EU.⁵⁹ Consistent with the EUSD and amendments made to Article 26 of the OECD Model Convention, the Council Directive provides for the compulsory automatic exchange of available information which cannot be refused *solely* on bank secrecy grounds.⁶⁰ Unlike the EUSD, however, this information exchange obligation initially covers five types of income⁶¹ which can be expanded to include dividend, capital gain and royalty income⁶² as part of a broader EU-wide automatic exchange of information

commonly known as the Foreign Account Tax Compliance Act (FATCA).” See U.S. Department of the Treasury, *U.S. Engaging with More than 50 Jurisdictions to Curtail Offshore Tax Evasion: Treasury Continues to Build International Support for Combating Offshore Tax Evasion and Facilitating FATCA Implementation*, Press Center (11/8/2012), accessible at: <http://www.treasury.gov/press-center/press-releases/Pages/tq1759.aspx>.

⁵⁷ On September 14, 2012, the United Kingdom became the first country to execute a bilateral FATCA compliance treaty. See U.S. Department of the Treasury, *Treasury, United Kingdom Sign Bilateral Agreement to Improve Tax Compliance, Combat Offshore Tax Evasion and Implement FATCA*, Press Center (9/14/12), accessible at: <http://www.treasury.gov/press-center/press-releases/Pages/tg1711.aspx>. Denmark, Mexico and Spain subsequently executed separate bilateral FATCA implementation agreements with the US Treasury on November 15, November 19, and November 20, 2012, respectively. See Danish Ministry of Taxation, *Memorandum of Understanding Regarding the Agreement Between the Government of the United States of America and the Government of the Kingdom of Denmark to Improve International Tax Compliance and to Implement FATCA* (Nov. 15, 2012), accessible at: <http://www.skm.dk/public/dokumenter/lovforslag/MOU.pdf>; InterAmerican Center of Tax Administrations, *Mexico - Agreement Between the Ministry of Finance and Treasury of the United States of America on the Exchange of Financial Information with Respect to FATCA* (Press Release Nov. 19, 2012) (english translation), accessible at: <http://www.ciat.org/index.php/pt/component/content/article/2435.html>; Ministry of Finance and Public Administration, Finance is Provided with New Tools to Combat International Tax Evasion, Press Release (11/20/12), accessible at: http://www.minhap.gob.es/es-es/prensa/en%20portada/2012/Paginas/20121120_Ferre.aspx (English translation); <http://www.minhap.gob.es/Documentacion/Publico/GabineteMinistro/Notas%20Prensa/2012/SE%20HACIENDA/20-11-12%20NP%20Fiscalidad%20Internacional.pdf> (Spanish translation). On December 3, 2012, Switzerland and the US signed their bilateral FATCA agreement. See Swiss Federal Department of Finance (FDF), *Switzerland and the U.S. Initial the FATCA Agreement*, Press Release (12/3/12), accessible at: <http://www.efd.admin.ch/dokumentation/medieninformationen/00467/index.html?lang=en&msg-id=47017>.

⁵⁸ See, e.g., Business and Industry Advisory Committee to the OECD ('BIAC'), Letter to Mr. Pascal Saint-Amans, Director OECD Centre for Tax Policy and Administration (March 23, 2012), accessible at: <http://www.uscib.org/docs/ATT2206817.pdf>.

⁵⁹ See Council of the European Union, *COUNCIL DIRECTIVE 2011/16/EU of 15 February 2011, on Administrative Cooperation in the Field of Taxation and Repealing Directive 77/799/EEC*, OJ L 64/1 (3/11/11) accessible at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:064:0001:0012:EN:PDF>.

⁶⁰ The Council Directive, like the Model OECD Convention, precludes Member States from refusing to supply such information *solely* on bank secrecy grounds. *Id.*, Article 18.2.

⁶¹ These include income from employment, directors' fees, pensions, life insurance products not covered by other Union legal instrument on exchange of information and other similar measure, ownership of and income from immovable property. *Id.*, Article 8.1(a)-(e).

⁶² See COUNCIL DIRECTIVE 2011/16/EU *supra* at Article 8.5(b).

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initiative comprising EU Member States interested in participating,⁶³ but which does not encourage non-EU Member State participation.⁶⁴

Despite the different approaches employed in the Council Directive and FATCA,⁶⁵ the EU Commission has expressed its full support for FATCA's objective of "combat[ing] cross-border tax evasion by US persons who use foreign financial institutions (FFIs) to hide assets and avoid reporting income taxable in the U.S.," which the EU views as being consistent with the aim of the Savings Directive.⁶⁶ The EU Commission arguably values FATCA because it "open[s] new perspectives for strengthening automatic information exchange between Member States and third countries."⁶⁷ In fact, the Commission has expressed its intention "to continue working with the US towards a *more ambitious approach* on automatic exchange of information for tax purposes to be implemented in the longer term."⁶⁸

Beyond Europe's regional enthusiasm for FATCA, some EU Member States have apparently begun to replicate it at the national level incident to their entering into bilateral negotiations with the U.S. concerning FATCA compliance. For example, during July 2011, the French Parliament enacted "new tax and disclosure requirements under the French Tax Code...*Loi de Finances Rectificative pour 2011*...that can affect certain trusts even if they are not otherwise residents of France",⁶⁹ despite the fact that "France doesn't recognize the concept of a trust" in its legal or tax code.⁷⁰ Some commentators have generally noted how the law's provisions "oblige trusts and their trustees to report

⁶³ See European Commission, Taxation and Customs Union, *Activities of the European Union (EU) in the Field in 2011* supra, at Section 4.2, p. 13, accessible at: http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/info_docs/tax_reports/report_activities_2011_en.pdf. See also COUNCIL DIRECTIVE 2011/16/EU, at Article 8.5.

⁶⁴ See Itai Grinberg, *Beyond FATCA: An Evolutionary Moment for the International Tax System*, supra at p. 21.

⁶⁵ The Commission was "concerned about the method used by the US. Indeed FATCA would involve high compliance costs for EU financial institutions and could also breach EU and Member States' law on data protection, withholding obligations and customer relations." See European Commission, Taxation and Customs Union, *Activities of the European Union (EU) in the Field in 2011* supra, at Section 4.5, p. 14.

⁶⁶ *Id.*

⁶⁷ See European Commission, *COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on Concrete Ways to Reinforce the Fight Against Tax Fraud and Tax Evasion Including in Relation to Third Countries*, COM(2012) 351 final (6/27/12), at Section 4.2, p. 11, accessible at: [http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/taxation/com\(2012\)351_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/common/publications/com_reports/taxation/com(2012)351_en.pdf).

⁶⁸ *Id.* (emphasis added).

⁶⁹ See RBC Investor Services, *New Trust Reporting Requirements in France* (Aug. 29, 2012), accessible at: <http://gmi.rbcis.com/rt/gss.nsf/bdce3819205ae55c852568a700004183/02871f8376fad7f985257a690065c017?OpenDocument>.

⁷⁰ See Kristen A. Parillo, *France's New Reporting Obligations for Trustees: FATCA Redux?*, *Worldwide Tax Daily* (2012 WTD 48-1) (), accessible at: http://www.sykesanderson.com/Document_Library/french-trustee-reporting-obligations.pdf; Helen Burggraf, 'French Mini-FATCA' Fears as France Goes After Trusts, *International Adviser* (Jan. 9, 2012), accessible at: <http://www.international-adviser.com/news/europe/talk-of-french-mini-fatca>.

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on the trust's French assets, their French beneficiaries, and/or French settlors,"⁷¹ while others have pointed out that such rules also require reporting even where "all the parties to the trust reside outside of France, if the trust holds any form of French asset, such as loans, real estate, stocks and shares."⁷² More recently, commentators in the UK have reported that the UK Government has drafted a plan to replicate FATCA domestically for purposes of securing FATCA-consistent automatic taxpayer information exchange agreements (TIEAs) with its Crown Dependencies and Overseas Territories.⁷³ While the UK, like the U.S. and France, is concerned that individuals' use of offshore "tax havens, such as the Cayman Islands, the Channel Islands and the Isle of Man"⁷⁴ is eroding its tax base, it was likely moved to action for reasons of maintaining legal consistency amid ongoing FACTA implementation agreement negotiations between the U.S. and Guernsey, Jersey⁷⁵ and the Isle of Man.⁷⁶

In conclusion, if imitation is the sincerest form of flattery and what often goes around comes around, then the steady development and evolution of FATCA into an internationally appealing global regime should warm the hearts of FATCA's U.S. congressional authors and simultaneously send a chill down the spines of U.S. and non-U.S. taxpayers alike.

For more information on FATCA, see [2012 Emerging Issues 6455](#); [2012 Emerging Issues 6586](#); [2012 Emerging Issues 6174](#)

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⁷¹ See Helen Burggraf, 'French Mini-FATCA' Fears as France Goes After Trusts, supra.

⁷² *Id.*

⁷³ See Robert Lee, *UK, IoM To Sign Enhanced TIEA*, Tax-News (Dec. 11, 2012), accessible at: http://www.tax-news.com/news/UK_IoM_To_Sign_Enhanced_TIEA_58707.html.

⁷⁴ See Salman Shaheen, *UK to Impose Son of FATCA on Crown Dependencies, Despite Government's Denials*, International Tax Review (Nov. 23, 2012), accessible at: <http://www.internationaltaxreview.com/Article/3121964/EXCLUSIVE-UK-to-impose-son-of-FATCA-on-Crown-Dependencies-despite-governments-denials.html>; Jamie Doward, *Treasury to Crack Down on UK's Offshore Tax Havens*, The Guardian Observer (Nov. 24, 2012), accessible at: <http://www.guardian.co.uk/business/2012/nov/25/treasury-british-tax-havens-crackdown>; Jonathan Kent, *Is UK Planning Fatca-Style Rules for Overseas Territories?*, The Royal Gazette Online (Dec. 4, 2012), accessible at: <http://www.royalgazette.com/article/20121204/BUSINESS02/712049952>.

⁷⁵ See BBC News Jersey, *Jersey and Guernsey's FATCA Talks with US 'Advanced'* (Dec. 1, 2012), accessible at: <http://www.bbc.co.uk/news/world-europe-jersey-20565989>.

⁷⁶ See Jason Gorringer, *Crown Dependencies To Strike FATCA Deals With US*, Tax-News (Oct. 10, 2012), accessible at: http://www.tax-news.com/news/Crown_Dependencies_To_Strike_FATCA_Deals_With_US_57701.html.

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