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**Automatic Exchange of Information:  
the rise of FATCA and CRS and consequent  
challenges for financial institutions**

Dissertation submitted in part fulfilment of the requirements  
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*“Globalization has made us more vulnerable. It creates a world without borders and makes us painfully aware of the limits of our present instruments, and of politics, to meet its challenges.”*

(Anna Lindh, former Swedish Minister for  
Foreign Affairs)



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## Declaration

The author hereby declares that the content of this dissertation is her own original and autonomous work. The author acknowledges that plagiarism constitutes a serious offense and certifies that specific references and sources have been cited and acknowledged as such within the body of the paper and that full bibliographic details are present in the reference list. This dissertation is presented in 77 pages and contains a total of 140,042 characters, including notes and spaces. It has not previously been submitted for any degree, diploma or other qualification.

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Emilie Pierlot

Lisbon, June of 2020

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## **Abstract**

The phenomenon of globalisation has facilitated the transnational movement of capital and, consequently, increased tax competition, resulting in a surge in offshore financial centres which have fostered a favourable climate for tax evasion and tax avoidance schemes. The global loss of revenue occasioned by such schemes is estimated to be significant, and there have been several attempts to curtail it through the years. The automatic exchange of information in tax matters is generally regarded as being the most effective method, by requiring that financial institutions report certain financial information from foreign account holders, thus allowing tax administrations to track and analyse the foreign investments of tax residents.

The aim of this dissertation is to analyse the two main regulations currently in place regarding the automatic exchange of financial account information for tax purposes, namely the United States' Foreign Account Tax Compliance Act and the OECD's Common Reporting Standard, as well as the impact of their provisions on financial institutions.





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## List of abbreviations

AEOI	Automatic Exchange of Information
CRS	Common Reporting Standard
DAC	Directive on Administrative Cooperation
DOJ	United States Department of Justice
EOIR	Exchange of Information on Request
FATCA	Foreign Account Tax Compliance Act
FFI	Foreign Financial Institution
FI	Financial Institution
GIIN	Global Intermediary Identification Number
IGA	Intergovernmental Agreement
IRS	Internal Revenue System
KYC	Know Your Customer
MCAA	Multilateral Competent Authority Agreement
NFE	Non-Financial Entity

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NFFE	Non-Financial Foreign Entity
OECD	Organisation for Economic Co-operation and Development
OFC	Offshore Financial Centre
QI	Qualified Intermediary
TIEA	Tax Information Exchange Agreement
TIN	Tax Identification Number

# Chapter 1

## Introduction

The international tax gap, defined as the difference between the total amount of international taxes owed by taxpayers to a government versus the amount the government actually receives<sup>1</sup>, due mainly to international tax non-compliance through tax avoidance and/or tax evasion, has been a mounting issue in the past few decades. In 2009, rough estimates of the international tax gap indicated that it could range from \$40 billion to \$123 billion<sup>2</sup> for the United States alone, the exact number being extremely difficult to accurately identify due to the veil of secrecy surrounding the activities generating it.

As taxation is a main source of income for governments all around the world, closing the tax gap has become an important challenge for tax administrations. Whilst some taxpayers use legal strategies to exploit loopholes (tax avoidance), which allow them to pay taxes in countries with a more favourable tax policy, others resort to illegal activities (tax evasion) to conceal would-be reportable income. Both schemes, however, often make use of the same methodology: the shifting of assets and income to Offshore Financial Centres (OFCs), more commonly known as secrecy jurisdictions or tax havens.

OFCs promote an attractive tax system for non-residents whilst guaranteeing some degree of opacity regarding financial flows, which in turn undermines the fiscal regulations of the jurisdictions which should have profited from the income generated

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<sup>1</sup> Definition taken from <http://www.businessdictionary.com/definition/tax-gap.html>

<sup>2</sup> Treasury Inspector General for Tax Administration, Ref. No. 2009-IE-R001, “A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap” (2009).  
<https://www.treasury.gov/tigta/iereports/2009reports/2009IER001fr.html>

by the aforementioned non-residents. The phenomenon of globalisation, whilst not new, has expanded in a way that has given rise to higher capital mobility and thus, indirectly, to global tax competition. As it has been said that smaller economies benefit from lowering the income taxes for income earned by foreign investors<sup>3</sup>, both OFCs and foreign investors stand to gain from a more competitive global market.

The flow of capital from foreign investors to low-tax regions by individuals and corporations seeking to capitalise on local regulations, in order to somewhat conceal their wealth and profit, has translated into a colossal loss of revenue for many governments. A study from 2018 assessed the global loss of tax revenue as a result of corporate tax avoidance and aggressive tax planning through profit shifting to be around \$500 billion per year.<sup>4</sup> On the other hand, the most conservative estimate on the global amount of individual wealth held offshore, calculated by economist Gabriel Zucman, indicated that \$8.7 trillion were stashed offshore by the end of 2016, of which around \$1.4 trillion were owned by U.S. residents and \$2.5 trillion by Europeans. That is 8% of the world financial wealth held offshore and an estimated global tax revenue loss of \$170 billion, with only 25% of offshore wealth being declared.<sup>5</sup>

Moreover, the use of OFCs is also of socio-political importance as, additionally to tax revenue losses, the capital outflow from higher-tax regions to OFCs has been linked to a number of criminal activities such as money laundering, corruption and terrorism financing. In December of 2016, the European Commission indicated that up to 70% of money laundering cases in Member States had a transnational dimension.<sup>6</sup>

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<sup>3</sup> CRUZ, José Manuel Neves. “A concorrência fiscal prejudicial dos paraísos fiscais e o desenvolvimento da cooperação internacional em termos de troca de informação”, (pp. 127-157). *Revista da Faculdade de Direito da Universidade do Porto, Vol. 11* (2014).

<sup>4</sup> COBHAM, Alex and JANSKÝ, Petr. “Global distribution of revenue loss from corporate tax avoidance: re-estimation and country results: Global Corporate Tax Avoidance.” *Journal of International Development*, 30. 206-232. 10.1002/jid.3348, (2018).

<sup>5</sup> ZUCMAN, Gabriel. “La richesse cachée des nations : Enquête sur les paradis fiscaux”. *Senil*, 2017.

<sup>6</sup> European Commission. “Security Union: Proposal for a Directive on countering money laundering by criminal law – Questions & Answers” (21/12/2016). [https://ec.europa.eu/commission/presscorner/detail/fr/MEMO\\_16\\_4452](https://ec.europa.eu/commission/presscorner/detail/fr/MEMO_16_4452)

Global tax cooperation and fiscal transparency is therefore essential for tackling the global issues originating from the use of OFCs and curtailing illicit financial flows. The European Union Savings Directive, implemented in 2003, is said to have paved the way for international cooperation on tax matters through the automatic exchange of information (AEOI). However, it was the introduction of the Foreign Account Tax Compliance Act (FATCA) in 2010, which aimed to identify instances of tax evasion by American individuals and corporations with offshore accounts, that became the turning point in addressing the issue of global tax compliance. A few years later, the Organisation for Economic Co-operation and Development (OECD) followed suit by developing what would become the Common Reporting Standard (CRS), which was first implemented in 2017.

Both FATCA and CRS are presently global transparency initiatives that require Foreign Financial Institutions to automatically report financial account information of specific account holders that are subject to reporting, as per the content of the regulations. Financial Institutions are instructed to implement exhaustive due diligence measures intending to hinder any attempt by account holders to bypass the reporting. The FATCA and CRS obligations are therefore an expansion of the pre-existing know-your-customer (KYC) requirements that Financial Institutions have to fulfil, mainly due to the added need for constant monitoring and reviewing of account holders' information and accounts, whereas KYC processes often simply follow a model of periodic reviews based on clients' risk-rating.

Since their introduction, Financial Institutions have been striving to conform to the newest AEOI stipulations, but they still face many hurdles in regards to their practical implementation.

The aim of this thesis will be to analyse the FATCA and CRS regulations and to assess their impact on financial institutions. Following the present introductory chapter, Chapter 2 begins with a review of the socio-political and economic context

that led to the development of FATCA and CRS, in the periods before and after the year 2008.

Chapter 3 offers an in-depth exposition of the concept of automatic exchange of financial account information for tax purposes, followed by a description of FATCA and CRS, a summary of their provisions and a breakdown of their domestic and international legal frameworks. Finally, the chapter concludes with an analysis of the main differences between both regulations.

Chapter 4 is dedicated to the assessment of the impact created by the introduction of the new regulatory requirements on financial institutions. The chapter discusses the financial institutions' increase in expenditures due to compliance costs, the difficulties encountered during the implementation of the reporting requirements, the penalties associated to non-compliance and the eventual methods that could be adopted in order to mitigate the impact.

Subsequently, Chapter 5 goes on to review the current state of FATCA and CRS and offers suggestions on which future additions could be made to optimize AEOI in tax matters.

Chapter 6 presents a summary of the topics discussed throughout this dissertation, followed by concluding remarks.



## Chapter 2

### Historical Context

This chapter presents an overview of the global socio-political and economic context having led to the development of FATCA and CRS by the IRS and the OECD respectively. Whilst the year 2008 appears to have been a critical juncture in the history of global tax transparency, partly due to an upsurge in tax scandals and to the perceived contribution of OFCs to the financial crisis, the evasion and avoidance of taxation is an old permeating issue that governments have been aware of since long before then.

#### 2.1. Pre-2008

The origins of OFCs can be traced back to the late nineteenth century, specifically to the United States of America where the states of New Jersey and Delaware were the firsts to adopt more permissive, “liberal” incorporation laws, devising the concept of “easy incorporation” for the purpose of attracting more non-resident corporations.<sup>7</sup> Together with the added concepts of “British virtual residencies” and “Swiss bank secrecy”<sup>8</sup>, which emerged at the beginning of the twentieth century, the foundation for the development of OFCs was laid.

On June 19, 1936, then-French Minister of Finance Vincent Auriol addressed the House of Representatives in a discourse in which he promoted international

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<sup>7</sup> PALAN, Ronen. “The Offshore World: Sovereign Markets, Virtual Places, and Nomad Millionaires”, (pp. 101-105). *Cornell University Press; 1 edition* (2003).

<sup>8</sup> Ibid.

cooperation in tax matters, promising “negotiations with the governments of neighbouring countries to prevent and repress, together, tax fraud and evasion.”<sup>9</sup>

On June 1, 1937, then-President of the United States Franklin D. Roosevelt wrote a message to the United States Congress regarding tax evasion and tax avoidance issues that had been identified during a preliminary study of income tax returns for the year 1936. In his message, the President expresses concerns regarding the fact that the study “reveals efforts at avoidance and evasion of tax liability, so widespread and so amazing both in their boldness and their ingenuity, that further action without delay seems imperative.” The message then goes on to quote a letter the Secretary of the Treasury, Henry Morgenthau Jr., addressed to the President, wherein he identifies “the device of evading taxes by setting up foreign personal holding corporations in the Bahamas, Panama, Newfoundland, and other places where taxes are low and corporation laws lax” as one of the “devices” used by taxpayers aiming to avoid compliance.<sup>10</sup>

Despite the awareness of world leaders regarding the issues relating to OFCs, attempts to curtail them were feeble at best, and many new regions mimicked the same model, aiming to replicate the success of early adopters. By the end of the twentieth century, a considerable increase in financial globalisation translated into a growth in financial interconnectedness.<sup>11</sup> A 1998 Report on Harmful Tax Competition by the OECD found that the “participation in [tax havens was] expanding at an exponential rate” and that “foreign direct investment by G7 countries in a number of jurisdictions in the Caribbean and in the South Pacific island states, which are generally considered

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<sup>9</sup> FARQUET, Christophe. “La défense du paradis fiscal suisse avant la Seconde Guerre mondiale : une histoire internationale”, (pp. 398) (citation translated by the author). *Editions Alphil Presses Universitaires Suisses* (2016).

<sup>10</sup> Franklin D. Roosevelt. “Message to Congress on Tax Evasion Prevention” (01/06/1937). <https://www.presidency.ucsb.edu/documents/message-congress-tax-evasion-prevention>

<sup>11</sup> The International Monetary Fund’s Strategy, Policy, and Review Department and the Monetary and Capital Markets Department, in collaboration with the Statistics Department and in consultation with other Departments. “Understanding Financial Interconnectedness” (2010). <https://www.imf.org/external/np/pp/eng/2010/100410.pdf>

to be low-tax jurisdictions, increased more than five-fold over the period 1985-1994”.<sup>12</sup> The 1998 Report also found that the key factors of harmful tax competition were jurisdictions having “no or low tax rates”, “ring fencing regimes”, a “lack of transparency” and a “lack of effective exchange of information”. Luxembourg and Switzerland, both member countries of the OECD, stated their disagreement with the findings of the Report and informed that they would not be bound by its recommendations. This decision showed continuity with later, similar refusals of OFCs regarding the signing of exchange of information bilateral treaties with other countries, as would be encouraged by the OECD.

The 1998 Report on Harmful Tax Competition by the OECD was an important first step in the crackdown on low-tax jurisdictions. It’s the first of its kind emphasising tax havens and defining the concept, and it originated the Forum on Harmful Tax Practices, which not only identified a list of tax havens, but also encouraged non-member countries to embrace the Report’s recommendations as well. It was a precursor of the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum), created in 2000.

The Global Forum, comprised at the time of its creation of 32 members (both OECD members and international financial centres), had for objective to work on the implementation of international standards on transparency and exchange of information for tax purposes, which would then be the basis for the signing of treaties between jurisdictions. One of the first action taken by the Global Forum was to threaten economic sanctions on the 35 countries identified as OFCs by the Forum on Harmful Tax Practices, if they did not agree to commit to implement the OECD standards on transparency and effective exchange of information for tax purposes. However, the political climate was not particularly propitious at the time, and the OECD’s project quickly got entangled in political red tape, facing considerable

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<sup>12</sup> OECD. “Harmful Tax Competition: An Emerging Global Issue”. *OECD Publishing, Paris*, (1998). <https://doi.org/10.1787/9789264162945-en>.

backlash from its opponents, including the OFCs themselves. Whilst OFCs with low levels of sovereignty seemed to comply with the requirements set out by the Global Forum so as to be taken off the blacklist, smaller independent OFCs decried the Global Forum's threats of sanctions, classifying them as an exercise in "economic imperialism", deploring the OECD's disregard for the principle of sovereignty and denouncing the fact that no OECD member was on the blacklist.<sup>13</sup>

Once the United States withdrew their support for the Global Forum, citing that their pursuits were "not in line with the administration's priorities" following the transition from the anti-tax havens Clinton administration to the Bush administration, all aspirations of economic sanctions were abandoned,<sup>14</sup> and the remainder of the project was pursued in a more subdued approach. By April 2002, through negotiations and due in part to a change in political leadership in some of the blacklisted jurisdictions, the Global Forum managed to bring the number on the blacklist down to seven, the remaining jurisdictions having committed to the OECD standards on transparency and exchange of information. The victory wasn't total, however, as not only was one of the standards' stipulations that all OECD member countries would have to abide by the same rules for it to be binding (including Switzerland and the United States)<sup>15</sup>, but the standards itself were lacking, being based on Exchange of Information on Request (EOIR), which implied that information about taxpayers could only be exchanged between two signatories of a treaty if the party requesting the information had reasonable cause to suspect that a resident of its country was engaged in tax evasion practices. The specificities of the standards lowered the probability of detecting tax evasions, with such constraints being acknowledged by advocates of the

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<sup>13</sup> VAN FOSSEN, Anthony B. "Money Laundering, Global Financial Instability, and Tax Havens in the Pacific Islands", (pp. 237-275). *The Contemporary Pacific*, 15(2) (2003).

<sup>14</sup> SHAXSON, Nicholas. "Treasure Islands: Tax Havens and the Men who Stole the World" (pp. 203-205). *Palgrave Macmillan* (2011).

<sup>15</sup> *Ibid.* 13

OECD who emphasised that even a low probability could be enough to deter any attempts.<sup>16</sup>

At around the same time, in January 2001, the United States unilaterally implemented the “Qualified Intermediary System” which required Qualified Intermediaries (QI) having signed a withholding agreement with the IRS to report any U.S. source of income of U.S. customers and to apply a withholding tax on payments from U.S. source to foreign customers. This system was, however, riddled with loopholes, namely the fact that it only applied to U.S. sources of income, which made it quite inefficient.<sup>17</sup>

Finally, in 2003, the European Union (EU) introduced the Savings Directive, the first legislative act setting out to implement a transnational automatic exchange of information regarding tax matters. Whilst the directive was of very limited scope (the “taxation of savings income in the form of interest payments on debt claims”<sup>18</sup> made in one Member State to an individual whose tax residence was in another Member State), it became an important precedent that indubitably facilitated the later implementation of the CRS.

## 2.2. The 2008 Shift in Political and Economic Climate

In 2008, a synchronous conjuncture of events took place, engendering an essential shift in the political climate regarding the necessity of adopting a stricter approach towards OFCs, which would later lead to the development of FATCA and CRS.

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<sup>16</sup> JOHANNESSEN, Niels, and ZUCMAN, Gabriel. "The End of Bank Secrecy? An Evaluation of the G20 Tax Haven Crackdown" (pp. 69). *American Economic Journal: Economic Policy*, 6 (1) (2014).

<sup>17</sup> HARVEY, J. Richard Jr. “Offshore Accounts: Insider's Summary of FATCA and Its Potential Future” (pp. 474-476). *Villanova Law Review*, Vol 57, Issue 3 (2012).

<sup>18</sup> Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments. *OJ L 157, 26.6.2003*, (p. 38–48).

### **2.2.1. LGT and UBS Tax Scandals**

The first event started to unfold in 2006, when an individual approached the German's Federal Intelligence Service with a detailed list of information relating to illicit financial flows made by German customers of the LGT Group, a financial institution based in the then-blacklisted principality of Liechtenstein. Once the ensuing investigation became public when, in February 2008, high-profile raids were conducted by German authorities based on suspicions of tax evasion, the German government announced that it would share the information garnered with the governments of other countries whose residents appeared to be involved.<sup>19</sup> The scandal quickly spread to the international stage, with the United States' IRS announcing that several members of the OECD's Forum on Tax Administration were working together on combating off-shore tax avoidance and evasion and that "enforcement action" was being initiated with respect to more than one hundred U.S. taxpayers in connection with accounts in Liechtenstein.<sup>20</sup>

A second scandal broke in May of 2008 when the United States Department of Justice (DOJ) charged former UBS private banker Bradley Birkenfeld with tax evasion conspiracy. The actions of the DOJ were later vastly criticised, as Birkenfeld had first approached the U.S. government in 2007, seeking to reveal crucial information regarding UBS' illicit practices whilst taking advantage of the whistle-blower provisions of the newly implemented Tax Relief and Health Care Act of 2006. When Birkenfeld requested immunity for his own involvement, the DOJ denied him, instead later sentencing him to 40 months in prison.<sup>21</sup> Despite his criminal treatment, Birkenfeld's volunteering of insider

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<sup>19</sup> "Liechtenstein Tax Scandal Spreads Across Europe". *Deutsche Welle* (25/02/2008). <https://p.dw.com/p/DD1A>

<sup>20</sup> IRS News Release. "IRS And Tax Treaty Partners Target Liechtenstein Accounts", IR-2008-26 (26/02/2008). <https://www.irs.gov/pub/irs-news/ir-08-026.pdf>

<sup>21</sup> WOOLNER, Ann. "UBS Whistleblower Gets Rewarded with Prison Time: Ann Woolner". *Bloomberg* (26/08/2009) <https://www.bloomberg.com/news/articles/2009-08-26/ubs-whistleblower-gets-rewarded-with-prison-time-ann-woolner>

information was pivotal to the IRS prosecution of UBS, which later led to the disclosure of an unprecedented amount of information regarding 4,450 U.S. clients with offshore accounts at UBS, a first in the history of Swiss bank secrecy, and drove UBS to agree to pay \$780 million to settle criminal charges with the DOJ.<sup>22</sup> It is important to note that UBS AG had entered a QI Agreement with the IRS in January of 2001, highlighting once more the lack of effectivity of the QI System.<sup>23</sup>

These two tax scandals – the firsts of many – helped fuel the efforts in tackling the issue of OFCs by uncovering essential information regarding tax evasion practices performed under the flag of banking secrecy laws.

### 2.2.2. The 2008 Financial Crisis

The causes of the 2008 Financial Crisis, often labelled as the worst worldwide economic disaster to have happened since the Great Depression, are diverse and complex, ranging from excessive risk-taking by financiers to regulators' lack of oversight. In 2009, at the peak of the crisis, as governments struggled to bailout the financial sector and society at large was still reeling, OFCs found themselves the target of public anger. Global leaders and economists alike were quick to point the finger, accusing OFCs of having somehow contributed to the collapse. Renowned economist Joseph Stiglitz, recipient of the Nobel Memorial Prize in Economic Sciences, seemed to indicate that the blame partially laid on the secondary shadow banking system present in OFCs.<sup>24</sup> In a speech addressing the issue of the financial crisis, then-French

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<sup>22</sup> BROWN, Tom. "Prosecution of UBS informant seen backfiring on U.S.". *Reuters* (09/10/2009). <https://www.reuters.com/article/us-ubs-tax-birkenfeld/prosecution-of-ubs-informant-seen-backfiring-on-u-s-idUSTRE59839720091009>

<sup>23</sup> The United States of America vs. UBS AG, Exhibit C. Case No. 09-60033-CR-COHN (2009) <https://www.sec.gov/Archives/edgar/data/1114446/000095012310024462/y83129exv4w1.htm>

<sup>24</sup> SCHÄFER, Ulrich. "Die Wall Street hat den Krieg der Worte verloren". *Süddeutsche Zeitung* (17/05/2010). <https://www.sueddeutsche.de/geld/joseph-stiglitz-zur-finanzkrise-die-wall-street-hat-den-krieg-der-worte-verloren-1.710585>

President Nicolas Sarkozy declared that, in order to rebuild, “it will also be necessary to ask upsetting questions like that of tax havens”.<sup>25</sup> Eventually, reputable news sources also published articles drawing a link between OFCs and the crisis.<sup>26</sup>

The correlation between both issues was not, however, universally acknowledged. A study from the Institute of Economic Affairs, authored by fourteen leading economists, indicated that the origin of the crisis could be traced back to government failure. In a statement published in *The Telegraph*, the authors of the study declared: “The prevailing view amongst the commentariat [...] that the financial crash of 2008 was caused by market failure is both wrong and dangerous” and “no significant changes are needed to the regulatory environment surrounding hedge funds, short-selling, offshore banks, private equity or tax havens”.<sup>27</sup>

Whether the OFCs were in part responsible for the collapse or not, the backdrop of the financial crisis gave governments a fresh impetus to promote some form of global cooperation and transparency in tax matters. The fact that some financial entities with offshore activity now had to be bailed out did not go unnoticed, and the popular opinion was negatively impacted. President Sarkozy asserted, during an European Council meeting in October of 2008, that “it would not be normal for a bank to which we would grant our own funds to continue to work in tax havens.”<sup>28</sup> The crisis also put extraordinary pressure on government revenues, and the revenue

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<sup>25</sup> “Déclaration de M. Nicolas Sarkozy, Président de la République, sur la crise financière internationale et la politique économique de la France, à Toulon le 25 septembre 2008”. <https://www.elysee.fr/front/pdf/elysee-module-11669-fr.pdf>

<sup>26</sup> PICCIOTTO, Sol. “How tax havens helped to create a crisis”. *Financial Times* (05/05/2009) <https://www.ft.com/content/96ec9414-39a6-11de-b82d-00144feabdc0>

ROBERTS, Dan. “Five reasons why tax havens and the banking crisis are linked”. *The Guardian* (17/03/2009). <https://www.theguardian.com/business/dan-roberts-on-business-blog/2009/mar/17/tax-banking-crisis>

<sup>27</sup> ALEXANDER, James et al. “Economists' letter spells out what went wrong”. *The Telegraph* (11/05/2009). <https://www.telegraph.co.uk/finance/recession/5309591/Economists-letter-spells-out-what-went-wrong.html>

<sup>28</sup> Assemblée nationale, XIIIe législature, Session ordinaire de 2008-2009, Compte rendu intégral : Première séance du mardi 21 octobre 2008. [http://www.assemblee-nationale.fr/13/cr/2008-2009/20090027.asp#P165\\_21556](http://www.assemblee-nationale.fr/13/cr/2008-2009/20090027.asp#P165_21556)



loss caused by the capital flow to OFCs could help finance the bailouts of failing financial institutions. Then-Swiss Foreign Minister Micheline Calmy-Rey confirmed in an interview in *Tribune de Genève* that the crackdown on OFCs would be “the logical consequence of the financial crisis”, as countries would be looking for a way to finance their bailout plans.<sup>29</sup>

In January of 2009, the inauguration of Barack Obama as President of the United States marked a pivotal moment in moving this endeavour forward, as President Obama was vocal in his stance against tax noncompliance through offshore tax havens, having co-sponsored the American “Stop Tax Haven Abuse Act” when he was still a Senator.<sup>30</sup> His somewhat populist stance was in alignment with the substantial change in the political climate that occurred following the LGT and UBS tax scandals, as well as the financial crash. On March 23, 2009, ahead of the G20 London Summit, President Obama wrote an op-ed urging the G20 leaders to follow the United States’ lead in a “coordinated international action” to restore the economy and prevent a new crisis, in which he pressed “we must crack down on offshore tax havens and money laundering”.<sup>31</sup> This sentiment was later echoed in the London Summit’s Leaders’ Statement, on April 2, 2009, wherein a readiness “to take action against non-cooperative jurisdictions, including tax havens” and “to deploy sanctions to protect our public finances and financial systems” was conveyed, followed by the proclamation that “the era of banking secrecy is over”.<sup>32</sup>

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<sup>29</sup> “Experts: Obama Will Demand End to Swiss Banking Secrecy”. *Deutsche Welle* (11/11/2008). <https://p.dw.com/p/FruR>

<sup>30</sup> U.S. Senate Committee on Homeland Security & Governmental Affairs. “Levin, Coleman, Obama Introduce Stop Tax Haven Abuse Act (S. 681)” (17/02/2017). <https://www.hsgac.senate.gov/subcommittees/investigations/media/levin-coleman-obama-introduce-stop-tax-haven-abuse-act-s-681>

<sup>31</sup> The White House, Office of the Press Secretary. “President Obama Op-Ed: A Time for Global Action” (24/03/2009). <https://obamawhitehouse.archives.gov/the-press-office/president-obama-op-ed-a-time-global-action>

<sup>32</sup> G20 Communiqué. “London Summit – Leaders’ Statement” (02/04/2009). [https://www.imf.org/external/np/sec/pr/2009/pdf/g20\\_040209.pdf](https://www.imf.org/external/np/sec/pr/2009/pdf/g20_040209.pdf)

The threat of economic sanctions by the G20 on OFCs finding themselves on the Global Forum's blacklist had an undeniable effect as, in just five days, all remaining blacklisted OFCs signed the mandatory 12 Tax Information Exchange Agreements (TIEA) on transparency and exchange of information for tax purposes in order to be identified as compliant. However, around a third of the TIEAs appeared to have been signed between OFCs, indicating that some OFCs only did the strict minimum to meet the requirements to be removed from the blacklist.<sup>33</sup> The TIEAs were also limited to the Exchange of Information on Request (EOIR), which was decried by many as not being exceedingly effective.

In October of the same year, the Obama administration introduced the first draft of the Foreign Account Tax Compliance Act, an “[amendment to] the Internal Revenue Code of 1986 to prevent the avoidance of tax on income from assets held abroad”, in the United States Senate.<sup>34</sup> This would open the door for the development of the CRS a few years later.

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<sup>33</sup> Ibid. 16

<sup>34</sup> Senate Bill 1934 - Foreign Account Tax Compliance Act of 2009 (27/10/2009). <https://www.congress.gov/bill/111th-congress/senate-bill/1934>

## **Chapter 3**

### **The Automatic Exchange of Information**

This chapter focuses on the concept of automatic exchange of financial account information for tax purposes and provides further insight regarding the Foreign Account Tax Compliance Act and the Common Reporting Standard, their legal frameworks and the main differences between both.

#### **3.1. What is it?**

The automatic exchange of financial account information for tax purposes is a direct successor of the Exchange of Information on Request principle, with a much wider range of application. Whereas EOIR is restricted to well-founded requests regarding limited financial information of individuals suspected of tax noncompliance, prohibiting so-called “fishing expeditions” and requiring the requesting party provides proof of “foreseeable relevance” i.e. a nexus between the requested information and an open inquiry or investigation,<sup>35</sup> AEOI is the routine, automatic transmission of pre-determined financial account information of account holders subject to reporting as per each specific AEOI agreement, without prior request.

FATCA and CRS are AEOI initiatives seeking to promote a global implementation of the AEOI approach in tax matters as a means to attain some form

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<sup>35</sup> OECD. “Implementing the Tax Transparency Standards: A Handbook for Assessors and Jurisdictions, Second Edition” (pp. 165-166). *OECD Publishing, Paris* (2011). <https://doi.org/10.1787/9789264110496-en>

of cross-border tax transparency, effectively allowing tax authorities to properly identify and investigate any attempt of tax noncompliance, therefore reducing the loss of tax revenue and curtailing illicit activities.

### **3.2. The Foreign Account Tax Compliance Act**

U.S. tax gap estimates for the year 2001<sup>36</sup> found that compliance was much higher with regards to amounts subject to third-party information reporting and withholding – findings which were later confirmed in the tax gap estimates of subsequent tax years.<sup>37</sup> FATCA is, in a way, a broader redesigning of the unilateral Qualified Intermediary System adopted in the United States in 2001, targeting tax noncompliance by U.S. taxpayers with offshore accounts through third-party reporting by Foreign Financial Institutions. The QI regime was expanded to close down on previously identified loopholes, to broaden the definition of financial intermediaries, and to introduce a withholding tax on U.S. source payments made to Foreign Financial Institutions (FFIs) refusing to enter an agreement with the IRS and comply with the reporting requirements.<sup>38</sup> However, it was soon noted that a few of the new provisions laid out by the regulation implied that some FFIs would have to violate local legislation in order to comply. For example, FFIs were expected to terminate the accounts of any recalcitrant account holder – i.e. account holders refusing to provide any documentation – and to report the information of U.S. persons identified by other

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<sup>36</sup> IRS, Office of Research. “Tax Year 2001 Federal Tax Gap Overview” (02/2007). <https://www.irs.gov/pub/irs-soi/01rastg07map.pdf>

<sup>37</sup> IRS, Office of Research. “Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013”, Publication 1415 (Rev. 9-2019) Catalog Number 10263H (pp. 13) (09/2019). <https://www.irs.gov/pub/irs-pdf/p1415.pdf>

<sup>38</sup> Ibid. 17, (pp. 479-482)

means to the IRS.<sup>39</sup> In an effort to settle this issue, the U.S. government began to examine the viability of coordinating with foreign governments so as to adopt an intergovernmental approach to FATCA, as opposed to the unilateral system between the United States and FFIs which had previously been in use.<sup>40</sup> Bilateral agreements were drawn up and the full implementation of FATCA, which was to become effective in 2013, was instead phased until 2017.<sup>41</sup>

### **3.2.1. FATCA Domestic and International Legal Framework**

FATCA was first enacted into law on March 18, 2010, under Title V (Subtitle A, §§ 501-541) of the Hiring Incentives to Restore Employment (HIRE) Act (Public Law n.º111–147).<sup>42</sup> The HIRE Act is a U.S. legislation that was meant to reduce the rate of unemployment that had spiked due to the 2008 financial crisis, and FATCA was initially introduced as a means to generate revenue that would be allocated to offset the cost of the hiring incentives provided by the law.

FATCA was codified in the Internal Revenue Code and a series of provisions were added or amended. Section 6038D was added to Subtitle F<sup>43</sup>, requiring U.S. taxpayers holding “any interest in a specified foreign financial asset”<sup>44</sup> to report specific information regarding such asset if the aggregate value of all assets exceeds \$50,000 (the amount varies depending on the marital status and residence of the U.S. taxpayer).

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<sup>39</sup> 26 U.S. Internal Revenue Code § 7701 (a) (1). “The term “person” shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.”

<sup>40</sup> U.S. Treasury Department “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” (02/07/2012). <https://bit.ly/3c0nyxU>

<sup>41</sup> IRS Notice 2013-43 (2013). <https://www.irs.gov/pub/irs-drop/n-13-43.pdf>

<sup>42</sup> Public Law No. 111-147, Tit. V, Subtit. A §§ 501-535, 124 Stat. 97-115 (2010) <https://www.congress.gov/111/plaws/publ147/PLAW-111publ147.pdf#page=27>

<sup>43</sup> 26 U.S. Code § 6038D. Information with respect to foreign financial assets. <https://www.govinfo.gov/content/pkg/USCODE-2016-title26/pdf/USCODE-2016-title26-subtitleF-chap61-subchapA-partIII-subpartA-sec6038D.pdf>

<sup>44</sup> *Ibid.*, article b.

A fourth chapter on “Taxes to Enforce Reporting on Certain Foreign Accounts” (Chapter 4) was added to Subtitle A<sup>45</sup>. Sections 1471 and 1472 added the requirement that a 30% tax should be withheld by the withholding agent with regards to any withholdable payment<sup>46</sup> made to a recalcitrant account holder, a Foreign Financial Institution that is nonparticipating<sup>47</sup> or a Non-Financial Foreign Entity (NFFE)<sup>48</sup> that either a) did not provide proof that it does not have any substantial U.S. owners or b) did not provide the required information regarding its substantial U.S. owners.<sup>49</sup>

An online system was created to facilitate the registration of FFIs and NFFEs with the IRS and each registered institution and entity was given a Global Intermediary Identification Number (GIIN), allowing them to identify themselves for FATCA reporting purposes. The FFI List, which is controlled by the IRS, is of public access and can be consulted by withholding agents to verify the status of an institution or entity, in accordance with Chapter 4 provisions.<sup>50</sup>

In order for the FFIs to be able to comply with the Chapter 4 reporting requirements when local banking and privacy laws may become an obstacle (e.g. the EU Data Protection Directive), the U.S. Department of Treasury entered numerous bilateral Intergovernmental Agreements (IGAs) based on two main models (Model 1

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<sup>45</sup> 26 U.S. Internal Revenue Code Chapter 4. “Taxes to Enforce Reporting on Certain Foreign Accounts”. <https://www.govinfo.gov/content/pkg/USCODE-2016-title26/pdf/USCODE-2016-title26-subtitleA-chap4.pdf>

<sup>46</sup> 26 USC § 1473(1)(A). “In general The term “withholdable payment” means— (i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States, and (ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.”

<sup>47</sup> An FFI that did not register with the IRS under FATCA.

<sup>48</sup> Ibid. 45, § 1472. “Withholdable payments to other foreign entities”. The term “non-financial foreign entity” means any foreign entity which is not a financial institution.

<sup>49</sup> Ibid. 45, § 1473. For definitions of the terms “withholdable payment”, “substantial U.S. owner” and “withholding agent”.

<sup>50</sup> “FATCA Registration and FFI List: GIIN Composition Information” <https://www.irs.gov/businesses/corporations/fatca-registration-and-ffi-list-giin-composition-information>

and Model 2). Both models highlight the terms of the agreement, the obligations with respect to the obtention and automatic exchange of information regarding reportable accounts, the time and manner in which the exchange must be made and the specific application of FATCA to be undertaken by financial institutions covered by the agreement. In a Model 1 IGA, the financial institutions of a foreign government have to report the reportable accounts information to such government, which will then transmit it to the IRS through AEOI. In a Model 2 IGA, the foreign government amends its laws for the purpose of allowing its FFIs to register and report directly to the IRS, in pursuance of the requirements of an FFI agreement.<sup>51</sup> As of May 2020, 113 jurisdictions had signed an IGA with the United States. The jurisdictions in question then have to carry out the necessary internal constitutional formalities for the implementation of the agreement's provisions into national law.<sup>52</sup> In the case of Portugal, for example, a Model 1 IGA was signed by the two governments on August 6, 2015,<sup>53</sup> which was then approved by the Assembly of the Republic on June 17, 2016, and ratified by the Decree of the President of the Portuguese Republic n.º 53/2016.<sup>54</sup> The IGA then became effective on August 31, 2016<sup>55</sup> and the Decree-Law n.º 64/2016, of 11 October was published<sup>56</sup>, approving complementary regulations as per article 16º of the “Financial Information Communication Regulation”<sup>57</sup> (RCIF)

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<sup>51</sup> An agreement concluded between an FFI and the IRS in accordance to Chapter 4 provisions.

<sup>52</sup> List of IGA Jurisdictions <https://home.treasury.gov/about/offices/tax-policy/foreign-account-tax-compliance-act>

<sup>53</sup> Resolução da Assembleia da República n.º 183/2016. *Diário da República*, 1.ª série — N.º 150 — 5 de agosto de 2016. <https://dre.pt/application/file/a/75106060>. Model 1 IGA <https://home.treasury.gov/system/files/131/FATCA-Agreement-Portugal-8-6-2015.pdf>

<sup>54</sup> Decreto do Presidente da República n.º 53/2016 de 5 de agosto. *Diário da República*, 1.ª série — N.º 150 — 5 de agosto de 2016. <https://dre.pt/application/file/a/75106058>

<sup>55</sup> Negócios Estrangeiros, Aviso n.º 101/2016. *Diário da República*, 1.ª série — N.º 175 — 12 de setembro de 2016. <https://dre.pt/application/conteudo/75307905>

<sup>56</sup> Finanças, Decreto-Lei n.º 64/2016, de 11 de outubro. *Diário da República* n.º 195/2016, Série I de 2016-10-11, páginas 3590 -3663. <https://dre.pt/application/conteudo/75504609>

<sup>57</sup> “Regime de comunicação de informações financeiras” (RCIF) (translation by the author).

introduced by the Law n.º 82-B/2014<sup>58</sup>, so as to “[fulfil the] obligations assumed by the Portuguese Republic within the scope of the mechanisms of international cooperation and combating tax evasion provided for in Convention between the Portuguese Republic and the United States of America to Avoid Double Taxation and Prevent Tax Evasion in Matters of Income Taxes and the Foreign Account Tax Compliance Act (FATCA)”.<sup>59</sup>

As per Portuguese domestic law, financial institutions have to report to the Portuguese Tax Authority, which then sends the information to the U.S. Competent Authority under the terms and conditions of the IGA.<sup>60</sup>

### **3.2.2. FATCA Reporting Requirements**

Under FATCA, FFIs are compelled to enter an FFI agreement with the IRS, thus becoming participating FFIs, to avoid being subject to a 30% withholding tax on U.S. source payments.<sup>61</sup> An FFI can also be considered compliant if it is located in a jurisdiction having signed a Model 1 or Model 2 IGA. Reporting Model 2 FFIs are participating FFIs as they are located in a Model 2 jurisdiction, which compels them to enter an FFI Agreement with the IRS. Other “deemed-compliant” FFIs include: registered deemed-compliant FFIs (which are required to register with the IRS), certified deemed-compliant FFIs, nonreporting IGA FFIs and, to some extent, owner-documented FFIs.<sup>62</sup>

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<sup>58</sup> Assembleia Da República, artigo 239 ° da Lei n.º 82-B/2014, de 31 de dezembro (Orçamento do Estado para 2015). *Diário da República n.º 252/2014, 1.º Suplemento, Série I de 2014-12-31, páginas 6546-(74) a 6546-(310)*.

<sup>59</sup> Ibid. 54, article 2 (1) (translation by the author).

<sup>60</sup> Ibid. 56, article 11 (1) (translation by the author).

<sup>61</sup> Ibid. 45, § 1471 (a).

<sup>62</sup> Ibid. 45, § 1471(a), (b)(2). Internal Revenue Service, Treasury. § 1.1471–1 Scope of chapter 4 and definitions. <https://www.govinfo.gov/content/pkg/CFR-2017-title26-vol14/pdf/CFR-2017-title26-vol14-sec1-1471-1.pdf>. A registered deemed-compliant FFI means an FFI that is either a (1) local FFI; (2) non-reporting member of a Participating FFI group; (3) qualified collective investment vehicle; (4)



An FFI can also elect to be withheld on payments received from recalcitrant account holders and Nonparticipating Foreign Financial Institutions rather than to deduct and withhold any withholdable payment made to such persons.<sup>63</sup>

Certain beneficial owners are exempt from the reporting requirements and any payment made to them will not be subject to a withholding tax.<sup>64</sup>

FFIs complying with the Chapter 4 reporting requirements have to implement extensive due diligence procedures through which each account holder can be correctly identified so as to determine if any financial account – whether it be a depository account, a custodial account or equity or debt interest not publicly traded –<sup>65</sup> is held by a specified U.S. person<sup>66</sup> or by a foreign entity with at least one substantial U.S. owner (U.S. person with more than 10% of ownership or interests). With respect to U.S.

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restricted fund; (5) qualified credit card issuer and servicer; (6) sponsored investment entity and controlled foreign corporation or; (7) is treated as a registered deemed-compliant FFI under a Model 2 IGA or is an FFI, or branch of an FFI, that is a reporting Model 1 FFI that complies with the registration requirements of a Model 1 IGA. A certified deemed-compliant FFI means an FFI that is either a (1) nonregistering local bank; (2) FFI with only low-value accounts; (3) sponsored, closely held investment vehicles; (4) limited life debt investment entities (transitional); (5) Certain investment entities that do not maintain financial accounts. A certified deemed-compliant FFI is not required to register with the IRS. A nonreporting IGA FFI means an FFI that is a resident of, or located or established in, a Model 1 or Model 2 IGA jurisdiction, as the context requires, and that is either a 1) nonreporting financial institution described in Annex II of the Model 1 IGA; (2) nonreporting financial institution described in Annex II of the Model 2 IGA; (3) registered deemed-compliant FFI; (4) certified deemed-compliant FFI; (5) exempt beneficial owner.

An owner-documented FFI means an FFI that meets the requirements of paragraph (f)(3)(ii).

<sup>63</sup> Ibid. 45, § 1471 (b)(3).

<sup>64</sup> Ibid. 45, § 1471(f). These exempt beneficial owners are (1) any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing; (2) any international organization or any wholly owned agency or instrumentality thereof; (3) any foreign central bank of issue, or; (4) any other class of persons identified by the Secretary for purposes of this subsection as posing a low risk of tax evasion.

<sup>65</sup> Ibid. 45, § 1471 (d)(2).

<sup>66</sup> Ibid. 45, § 1473 (3). A specified U.S. person is any U.S. person other than (1) any publicly listed company; (2) any corporation which is a member of the same expanded affiliated group as a publicly listed company; (3) any organization exempt from taxation under section or an individual retirement plan; (4) the U.S. or any wholly owned agency or instrumentality thereof; (5) any State, the District of Columbia, any possession of the U.S., any political subdivision of any of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing; (6) any bank; (7) any real estate investment trust; (8) any regulated investment company; (9) any common trust fund, and (10) other trusts to a certain extent.

accounts held (in whole or in part) by a natural person, they will only be subject to reporting if the aggregate value of all depository accounts maintained by the same financial institution (and any member of its expanded affiliated group) exceeds \$50,000 – unless the financial institution elects to report on all U.S. accounts, regardless of value. The information subject to reporting are the name, address and TIN of any U.S. account holder or substantial U.S. owner, the account number, the account balance or value, and the gross receipts and withdrawals or payments from the account.<sup>67</sup> Such information has to be reported via a Form 8966 on an annual basis. If a local law prevents the financial institution from obtaining the necessary information from the U.S. account holder, a waiver of such law needs to be provided by the account holder. Any failure to do so will have to result in the closure of the account.

Any reporting FFI will also have to withhold a 30% tax on passthru payments<sup>68</sup> made to recalcitrant account holders or any other Nonparticipating FFI, as well as on passthru payments made to FFIs having elected to be withheld upon in the amount that is allocable to recalcitrant account holder or Nonparticipating FFIs.

The accounts do not have to be reported if they've already been subject to reporting by another financial institution or by the holder of the account.<sup>69</sup>

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<sup>67</sup> Ibid. 45, § 1471(c).

<sup>68</sup> Ibid. 45, § 1471(d)(7). “The term “passthru payment” means any withholdable payment or other payment to the extent attributable to a withholdable payment”. The second part of this definition, regarding “other payment to the extent attributable to a withholdable payment” refers to so-called “foreign passthru payments”. A foreign passthru payment is made when a U.S. Specified Person or Recalcitrant Account Holder received indirect payment from a U.S. source through their investment in an NPFFI which has invested in an PFFI which invests in U.S. source assets. Whilst the payment from the PFFI to the NPFFI is not directly withholdable, being foreign-to-foreign, it would indirectly originate from a U.S. source. The concept of the foreign passthru payment was to apply a withholding tax on such payments. However, in practice, it is extremely difficult to identify whether a payment is attributable to a withholdable payment, and there might be local legal restrictions on doing so for payments no directly connected to the U.S. Because of these constraints, the withholding of foreign passthru payments is currently deferred and no official definition was published, as the IRS tries to find a way to eliminate the loophole. The withholding on foreign passthru payments will only be enforced two years from the moment as official definition is published. (83 FR 64757) <https://www.federalregister.gov/documents/2018/12/18/2018-27290/regulations-reducing-burden-under-fatca-and-chapter-3>

<sup>69</sup> Ibid. 45, § 1471(b)(1), (d)(1).

A withholding tax of 30% may also be applicable in the case of withholdable payments made to an NFFE, as referred previously, if the NFFE did not provide either a certification that it does not have any U.S. substantial owner or the name, address and TIN of each of its U.S. substantial owner, the latter being reportable. This provision does not apply to exempt beneficial owner to the extent listed in the law not to classes of payments posing a low risk of tax evasion.<sup>70</sup>

The above-listed requirements may vary depending on the content of the FFI Agreement or the IGA, as the case may be. In the case of Portugal, for example, pursuant to subparagraph 2 of Article 4 of the Model 1 IGA between the United States and the Portuguese Republic, the rules relating to recalcitrant accounts are suspended, thereby a Portuguese financial institution is not required to withhold tax under section 1471 or 1472 of Chapter 4, or to close such accounts, if the U.S. Competent Authority receives the information set out in the agreement.<sup>71</sup>

### **3.2.3. The Evolution of FATCA**

FATCA was implemented gradually over time and new changes are still being introduced through Notices and Final Regulations, which are promulgated based on public-comment. In 2017, the Treasury Department and the IRS issued several notices stating their intent to amend temporary regulations through the publication of Final Regulations, and providing new temporary guidance until the release of such

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<sup>70</sup> Ibid. 45, § 1472. Exempted beneficial owners in this case means: (1) any publicly traded corporation; (2) any member of the same affiliated group as a publicly traded corporation; (3) any entity which is organized under the laws of a possession of the United States and which is wholly owned by one or more bona fide residents of such possession; (4) any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing; (5) any international organization or any wholly owned agency or instrumentality thereof; (6) any foreign central bank of issue or; (7) any other class of persons identified by the Secretary for purposes of this subsection, and

<sup>71</sup> IGA Model 1, Portuguese jurisdiction. <https://home.treasury.gov/system/files/131/FATCA-Agreement-Portugal-8-6-2015.pdf>

regulations. In December 2018, following much criticism regarding the compliance burden that FATCA imposed on U.S. citizens living abroad, and in response to Executive Orders 13777 and 13789, the Treasury Department and the IRS disclosed proposed regulations (REG-132881-17) that aimed to mitigate taxpayer burden through the narrowing of the scope of certain reporting requirements under Chapter 3 and Chapter 4. Amongst the provisions of REG-132881-17 was the previously mentioned deferment of withholding on foreign passthru payments. Other provisions concerned the elimination of the withholding on payments of gross proceeds and on certain insurance premiums, the clarification of the definition of investment entity, and guidance regarding certain due diligence requirements and the refunds and credits of amounts withheld.<sup>72</sup> In January 2020, part of the proposed regulations published in REG-132881-17 were incorporated, with some modifications, in the Final Regulations TD 9890,<sup>73</sup> whilst the remaining provisions were set to be finalised in another, future guidance. The regulations provided, amongst other things, some clarifications on the requirement for withholding agents that are a U.S. branches or offices of a financial institution to obtain a foreign Tax Identification Number (TIN), whilst allowing the collection of such information through a specific type of written statement.

Despite the constant evolution of FATCA regulations, some issues still persist. For example, the question of the withholding on foreign passthru payments, arguably a significant remaining loophole, has yet to be solved. And the mandatory collection of U.S. TINs with regards to pre-existing account holders subject to reporting remains quite controversial since, in practice, as the TIN has only become mandatory in the

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<sup>72</sup> Regulations Reducing Burden Under FATCA and Chapter 3, REG-132881-17. *Federal Register/ Vol. 83, No. 242 / Tuesday, December 18, 2018 / Proposed Rules.* <https://www.govinfo.gov/content/pkg/FR-2018-12-18/pdf/2018-27290.pdf>

<sup>73</sup> Regulations Relating to Withholding and Reporting Tax on Certain U.S. Source Income Paid to Foreign Persons, TD 9890. *Federal Register/ Vol. 85, No. 1 / Thursday, January 2, 2020 / Rules and Regulations.* <https://www.govinfo.gov/content/pkg/FR-2020-01-02/pdf/2019-27979.pdf>

United States in 1986, many U.S. citizens who have been living abroad since before then do not have one. Under these circumstances, the issue had to be addressed in Notice 2017-46, and a relief was provided for Reporting Model 1 FFIs through a transition period ending on December 31, 2019, during which the U.S. TINs were not required. As of 2020, whilst the TINs are now required to be reported, the issue still persists. Reporting Model 1 FFIs are not obligated to close reportable pre-existing accounts with no TIN, however the IRS will evaluate if its absence constitutes significant non-compliance, which could translate into a Reporting Model 1 FFI being considered a Non-Participant FFI.<sup>74</sup> This issue has been the source of much preoccupation for financial institutions, namely in France where 40,000 such accounts are concerned.<sup>75</sup>

### 3.3. The Common Reporting Standard

The automatic exchange of information in the European Union was the subject of years of political back and forth, mainly due to the reluctance of Austria and Luxembourg to lift their vetoes regarding the amendment of the Savings Directive after several loopholes had been identified. In the end, it took the implementation of FATCA and the aggressive push regarding the conclusion of intergovernmental agreements between the United States and several Member States to pressure the most disinclined governments to release their hold on banking secrecy.<sup>76</sup>

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<sup>74</sup> Frequently Asked Questions FAQs FATCA Compliance Legal Reporting, Q3. <https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-legal>

<sup>75</sup> BURGGRAF, Helen. “French finance minister reassures French banks over FATCA concerns, on eve of TIN reporting dead”. *American Expat Financial News Journal* (01/01/2020). <https://americanexpatfinance.com/news/item/342-french-minister-reassures-french-banks>

<sup>76</sup> GIEGOLD, Sven, MEP. “How Luxembourg resisted European tax cooperation and made money with its circumvention”, Chapter 3 (pp. 17-18) (29/05/2017). [https://www.greens-efa.eu/files/assets/docs/pana\\_hearing\\_of\\_jean-claude\\_juncker.pdf](https://www.greens-efa.eu/files/assets/docs/pana_hearing_of_jean-claude_juncker.pdf)

On July 26, 2012, after the introduction of FATCA intergovernmental agreements, then-OECD Secretary-General Angel Gurría expressed: “I warmly welcome the co-operative and multilateral approach on which the model agreement is based. We at the OECD have always stressed the need to combat offshore tax evasion whilst keeping compliance costs as low as possible. A proliferation of different systems is in nobody’s interest. We are happy to redouble our efforts in this area, working closely with interested countries and stakeholders to design global solutions to global problems to the benefit of governments and business around the world”.<sup>77</sup>

The Common Reporting Standard, endorsed by the G20 in September of 2014, was adopted by the EU through an amendment of the Directive on Administrative Cooperation (DAC2) in December of the same year<sup>78</sup>, and the Savings Directive was repealed on November 10, 2015, due to its consequent overlapping. The standard was modelled after the Model 1 intergovernmental agreement in an attempt to minimise implementation costs for financial institutions and maximise its efficiency.<sup>79</sup>

On a global level, the development of the CRS appeared to be a success, as by May 2014, 60 countries had committed to implement the Standard.<sup>80</sup>

### **3.3.1. CRS Domestic and International Legal Framework**

The implementation of the CRS into domestic law can be done with recourse to several different legal bases, in such a way that will be in alignment with the local

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<sup>77</sup> OECD. “Tax: OECD welcomes multilateral efforts to improve international tax compliance and transparency” (2012). <https://www.oecd.org/ctp/taxoecdwelcomesmultilateraleffortstoimproveinternationaltaxcomplianceandtransparency.htm>

<sup>78</sup> OECD. “A Brief History of AEOI”. <https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/>

<sup>79</sup> OECD. “Standard for Automatic Exchange of Financial Account Information in Tax Matters, Second Edition” (pp. 10). *OECD Publishing, Paris* (2017). <http://dx.doi.org/10.1787/9789264267992-en>

<sup>80</sup> Ibid.

restrictions of each jurisdiction. Bilateral agreements can be concluded between two jurisdictions via Double Tax Treaties or TIEAs (if AEOI provisions are specifically included), or either based on Article 26 of the Model Tax Convention on Income and on Capital, or on Article 6 of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The latter is also the legal basis for the Multilateral Competent Authority Agreement (MCAA), which offers a multilateral framework of global reach, allowing for two or more parties to enter the agreement whilst ensuring a bilateral exchange of information. As of December 24, 2019, 109 jurisdictions had signed the MCAA.<sup>81</sup> At the European level, Directive 2014/107/EU of 9 December 2014 (DAC2)<sup>82</sup> was introduced by the Council of the European Union, adopting the text of the CRS through the amendment of Directive 2011/16/EU.<sup>83</sup>

In order to ensure the proper translation of the CRS into domestic law, it was necessary for jurisdictions to implement the requirements through an amendment or an addition in legislation. Taking the example of Portugal, Article 188 of the State Budget Law n.º 7-A/2016<sup>84</sup> was the primary legislation introduced with respect to the transposition into national law of DAC2, fulfilling the requirement for legislative authorisation. The Decree-Law n.º 64/2016<sup>85</sup> then transposed DAC2 into national legislation. The provisions of the Decree-Law established, namely: (1) the categories of reporting financial institutions and financial accounts and the specific data which the Tax Authority is obliged to report; (2) the categories of non-reporting financial institutions, as well as the list of excluded accounts which are low risk and meet the

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<sup>81</sup> Signatories of The Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and Intended First Information Exchange Date: Status as of 24 December 2019. <https://www.oecd.org/ctp/exchange-of-tax-information/crs-mcaa-signatories.pdf>

<sup>82</sup> Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation. *OJ L 359*, 16.12.2014, p. 1–29.

<sup>83</sup> GUTIERREZ, Jorge A. F. and GONZÁLEZ-BARREDA, Pablo A.H. “Combating Tax Avoidance in the EU: Harmonization and Cooperation in Direct Taxation”. *Kluwer Law International B.V.* (2018).

<sup>84</sup> Assembleia Da República, artigo 188º da Lei n.º 7-A/2016 de 30 de março. *Diário da República*, 1.ª série — N.º 62 — 30 de março de 2016.

<sup>85</sup> *Ibid.* 56



regulatory requirements; (3) the concrete financial information that must be the object of communication and exchange, in respect to income categories and the account balances and assets; (4) the set of procedures that must be applied by the reporting financial institutions in terms of communication and due diligence and; (5) the rules that must be observed in the processing of data by the reporting financial institutions, the Tax Authority and the Member States or other jurisdictions receiving the information exchanged, in order to safeguard fundamental rights and personal data protection principles. Several other amendments, described in article 188 of Budget Law n.º 7-A/2016, were also made to other pre-existing legislations in order to harmonise the implementation of the CRS into national law.

Out of the jurisdictions having committed to first exchanges under the CRS by 2019, 98% had the required domestic legal framework in place and, to date, 104 jurisdictions have implemented the international legal framework.<sup>86</sup>

### **3.3.2. CRS Reporting Requirements**

A Reporting Financial Institution, according to CRS guidelines, is a Financial Institution located in a Participating Jurisdiction<sup>87</sup> that is not a Non-Reporting Financial Institution, as per the provisions of the agreement. With respect to branches of a Financial Institutions (FIs), only branches located in a Participating Jurisdiction are subject to the reporting rules of such jurisdiction. The location of an FI is mainly determined by its tax residence, or by the jurisdiction wherein the financial accounts are located, if the FI is resident in multiple jurisdictions. An entity which does not have a tax residence will be treated as resident of the jurisdiction in which it is incorporated, in which it has its place of management or in which it is subject to financial supervision.

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<sup>86</sup> OECD. “The 2019 AEOI Implementation Report” (pp. 10) (2019). <https://www.oecd.org/tax/transparency/AEOI-implementation-report-2019.pdf>

<sup>87</sup> A jurisdiction having implemented the CRS.



Trusts are considered to be residents in the jurisdiction where its trustees are residents unless it is considered tax resident of another jurisdiction.

A Reporting Financial Institution, for the purposes of the CRS, is any of the following: a depository institution (e.g. savings banks, commercial banks, savings and loan associations, credit unions); a custodial institution (e.g. custodian banks, brokers, central securities depositories); an investment entity (e.g. entities investing, reinvesting or trading in financial instruments, portfolio management or investing, administering or managing financial assets) or; a specified insurance company (e.g. most life insurance companies). Non-Reporting Financial Institutions – i.e. financial institutions that are exempted from the reporting – are similar to the Exempt Beneficial Owners defined in FATCA and can be any of the following: a governmental entity and its pension funds; an international organisation; a central bank; certain retirement funds; a qualified credit card issuer; an exempt collective investment vehicle; a trustee documented trust or; other low-risk financial institutions.<sup>88</sup>

Similarly to FATCA, Reporting FIs have to apply extensive due diligence measures in order to identify would-be reportable financial accounts. Financial accounts, under the CRS, are depository accounts, custodial accounts, equity and debt interest in certain investment entities, cash value insurance contracts and annuity contracts. Some accounts are, however, considered low-risk and therefore excluded from reporting; for those accounts no due diligence needs to be enacted.<sup>89</sup>

Reportable Financial Accounts are the financial accounts maintained in a Reporting Financial Institution which are subject to reporting to the tax authority of the jurisdiction in which the FI is located. A Reportable Account is “an account held

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<sup>88</sup> OECD. "Commentaries on the Common Reporting Standard", in *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, Second Edition, *OECD Publishing, Paris* (pp. 158-174) (2017). <https://dx.doi.org/10.1787/9789264267992-7-en>

<sup>89</sup> *Ibid.* (pp. 175-191). Excluded accounts are, as listed in the CRS, (1) retirement and pension accounts; (2) non-retirement tax-favoured accounts; (3) term life insurance contracts; (4) estate accounts; (5) escrow accounts; (6) depository accounts due to not-returned overpayments and; (7) other low-risk excluded accounts.

by one or more Reportable Persons or by a Passive NFE with one or more Controlling Persons that is a Reportable Person”.<sup>90</sup>

The CRS defines a Reportable Person as a Reportable Jurisdiction Person – an individual or entity resident in a Reportable Jurisdiction (i.e. a jurisdiction having an obligation to exchange information as per the agreement in place with the jurisdiction in which the Reporting FI is located) – other than a publicly traded corporation or its related entities, a governmental entity, an international organisation, a central bank or a financial institution.

A Reporting Financial Institution therefore has to identify any financial account held by one or more Reportable Persons for effects of reporting, in which case the accounts are reported in relation to the Account Holder and the name, address, jurisdiction(s) of residence, TIN(s) and date and place of birth of the Reportable Persons are collected, as well as the account number, amongst other things.<sup>91</sup>

The other type of Reportable Account, which is reported in relation to the Controlling Persons, are Passive NFEs with one or more Reportable Persons as Controlling Persons. Passive NFEs are one of two categories of Non-Financial Entities. Non-Financial Entities, as categorised in the CRS, are entities that are not Financial Institutions, and can either be Active or Passive. An Active NFE can be any of the following: a publicly traded NFE; a governmental entity; an international organisation; a central bank or its wholly owned entities; a holding NFE that is member of a nonfinancial group; a start-up NFE; an NFE that is liquidating or emerging from bankruptcy; a treasury centre that is member of a nonfinancial group; a non-profit NFE or; an active NFE by reason of income and assets (less than 50% of the NFE’s gross income for the preceding calendar year is passive income and less than 50% of the assets held by the NFE during the preceding calendar year are assets that produce or are held for the production of passive income). Essentially, Passive NFEs are NFEs

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<sup>90</sup> Ibid. (pp. 191)

<sup>91</sup> Ibid. (pp. 94-101)

that are not considered Active, i.e. entities with passive income and assets that produce or are held to produce passive income. In addition, any Investment Entity managed by another Financial Institution that is not located in a Participating Jurisdiction will also be considered as a Passive NFE.

If an Account Holder is a Passive NFE, the Controlling Persons have to be identified in order to determine whether the account should be reportable. The Controlling Persons are usually the natural persons having direct or indirect ownership of the entity (owning, through shares or voting rights, more than a certain percentage, determined through a risk-based approach, usually either 10% or 25%), or, when no natural persons exercise control through ownership, any natural persons who exercise control of the Entity through other means (e.g. senior managing official).<sup>92</sup> If one or more Controlling Persons of a Passive NFE is identified as a Reportable Jurisdiction Person, their financial accounts will be considered reportable and the name, address, jurisdiction(s) of residence and TIN(s) of the Entity will be collected along with the name, address, jurisdiction(s) of residence, TIN(s) and date and place of birth of each Reportable Person and their account number, amongst other things.<sup>93</sup>

Jurisdictions may opt to adopt the Wider Approach, which, as described in Annex 5 of the CRS, allows jurisdictions to extend the definition of Reportable Persons to include all non-residents, residents of jurisdictions with which they have an exchange of information agreement, and even their own residents in order to alleviate the burden on jurisdictions in implementing the CRS and on Financial Institutions having to comply with reporting requirements. Each jurisdiction can also create a list of low risk non-reporting FIs and excluded accounts, which is made publicly available on the OECD's Automatic Exchange Portal.<sup>94</sup>

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<sup>92</sup> Ibid. (pp. 195-199)

<sup>93</sup> Ibid. (pp. 94-101)

<sup>94</sup> OECD "Automatic Exchange Portal". <https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction/>

### **3.3.3. The Evolution of the CRS**

Constant developments are made to maintain the CRS up to date and relevant. In February of 2018, a loophole regarding the use of residence or citizenship by investment schemes was identified, where the CRS could potentially be circumvented through the inaccurate or incomplete reporting of a taxpayer's tax residence. The OECD released consultation documents addressing the issue and identified a list of 20 countries with "high-risk" schemes, however the efforts to close down on this loophole remains insufficient, as analysed later in this document.<sup>95</sup>

In March of 2018, the OECD released the new Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures (MDRs),<sup>96</sup> which was based on the BEPS Action 12 Report<sup>97</sup> and specifically targeted schemes created to avoid CRS reporting or hide ultimate beneficial owners, by making it mandatory for certain financial intermediaries to disclose such schemes to tax authorities. Amongst the definitions of "CRS Avoidance Arrangements" is the arrangement that seeks to "[undermine or exploit] weaknesses in the due diligence procedures used by Financial Institutions to correctly identify an Account Holder and/or Controlling Person or all the jurisdictions of tax residence of an Account Holder and/or Controlling Person". These new disclosure rules were essential for the

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<sup>95</sup> OECD. "OECD clamps down on CRS avoidance through residence and citizenship by investment schemes" (2018). <https://www.oecd.org/ctp/oecd-clamps-down-on-crs-avoidance-through-residence-and-citizenship-by-investment-schemes.htm>

<sup>96</sup> OECD. "Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures", OECD, Paris (2018). [www.oecd.org/tax/exchange-of-information/model-mandatory-disclosure-rules-for-crs-avoidance-arrangements-and-opaque-offshore-structures.pdf](http://www.oecd.org/tax/exchange-of-information/model-mandatory-disclosure-rules-for-crs-avoidance-arrangements-and-opaque-offshore-structures.pdf)

<sup>97</sup> BEPS refers to Base Erosion and Profit Shifting. They are aggressive tax planning tactics used by multinational corporations to "[exploit] gaps and mismatches between different countries' tax systems", mainly through the shifting of profits to OFCs. In an effort to combat such tactics, over one hundred countries joined the OECD/G20 Inclusive Framework on BEPS, which released the "BEPS Package", providing a set of 15 Actions to be implemented by countries to tackle tax avoidance. Action 12 delivers "recommendations for the design of rules to require taxpayers and advisors to disclose aggressive tax planning arrangements". <https://www.oecd.org/tax/beps/>

purpose of guaranteeing the efficacy of the CRS reporting, as such arrangements would undermine the efforts of financial institutions to determine which account is to be considered reportable. In June of 2019, the OECD released an international framework for the exchange of information collected under the MDRs, including a draft of the multilateral Competent Authority Agreement on which the exchanges were to be based.

At the European level, the Directive on Administrative Cooperation kept evolving, introducing new obligations for financial institutions in Member States. As of June 2020, Directive 2011/16/EU had been amended five different times in order to include the automatic exchange of information on advance cross-border tax rulings and advance pricing agreements, the mandatory automatic exchange of information on country-by-country reporting of multinational corporations, the access by tax authorities to beneficial ownership information collected by financial institutions pursuant to the anti-money laundering Directive and the automatic exchange of information of reportable cross-border tax-planning arrangements. The mandatory disclosure rules set out by the BEPS Action 12 report were adopted by EU Member States through the enactment of Directive (EU) 2018/822 of 25 May 2018 (DAC6),<sup>98</sup> the latest amendment to Directive 2011/16/EU. DAC6 established a “specific hallmark concerning automatic exchange of information and beneficial ownership”, incorporating the OECD MDRs, under which certain arrangements are considered as undermining the reporting obligations of Member States regarding the AEOI of financial account information and targeting arrangements obfuscating the beneficial ownership chain. DAC6 introduces another dimension to the issue by specifically targeting cross-border arrangements, attending to the fact that most aggressive tax-planning arrangements have a transnational nature. Under DAC6, certain EU-based

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<sup>98</sup> Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements. *OJ L 139, 5.6.2018, p. 1–13.*

financial intermediaries are required to disclose information on reportable cross-border tax-planning arrangements to their local tax authority, which then have to share the information with tax authorities of other Member States. The Directive presents a list of hallmarks, i.e. indications that an arrangement or transaction could be used for tax avoidance purposes. A cross-border arrangement becomes reportable when at least one of the hallmarks is met. Arrangements concerning the automatic exchange of information and beneficial ownership, transfer pricing, and certain types of cross-border transactions do not have to meet the “main benefit test” to be reportable. The main benefit test applies to arrangements from which the main benefit a person can reasonably expect to derive is the obtaining of a tax advantage, as per defined in Annex IV of the Directive. The intermediaries targeted by the provisions are mainly tax and financial advisers, accountants, lawyers or any person linked with the planning, managing or marketing of reportable cross-border arrangements. As per Article 25a, the provisions pursuant to DAC6 have to be transposed to domestic laws by the Member States, and the penalties associated to the infringements of such provisions have to be determined by each Member State.

In Portugal, the transposition of DAC6 into domestic law was drafted in bill n.º 11/XIV/1.<sup>a</sup>, published in May 2019 and approved by the Assembly of the Portuguese Republic on May 28, 2020. The bill, if promulgated by the President of the Republic, would repeal the Decree-Law n.º 29/2008, which introduced duties of communication to the tax administration to prevent and combat abusive tax planning, due to overlapping provisions. It has, however, been highly criticised due to the fact that the scope of obligations proposed is much broader than the one required by DAC6. For example, the bill would be applicable for arrangements both with or without a cross-border dimension as long as they are designed to be applied or produce effects in the Portuguese territory. The most controversial provision proposed by the bill concerns the prevailing of reporting duties by intermediaries over their legal or contractual professional privilege, which pushed the Portuguese Bar Association, the National

Data Protection Commission, the Chartered Accountants Association and many others to issue negative opinions regarding the bill, denouncing the provision as being a violation of the principles of the rule of law. Indeed, whereas the Directive specifically refers that Member States are allowed to give intermediaries the right to a waiver when a reporting obligation would originate a breach of legal professional privilege under national law, therefore transferring the obligation to another intermediary or to the taxpayer benefitting from the arrangement, bill n.º 11/XIV/1.<sup>a</sup> simply discards the option.<sup>99</sup> Such is a good example of minimum harmonisation, in which case a Member State is allowed to set stricter standards than the ones set in the Directive. As of June 2020, DAC6 had been transposed into the national law of 19 of the 27 Member States.

### 3.4. Main Differences Between FATCA and CRS

The Common Reporting Standard has sometimes been referred to as the “global version” of the Foreign Account Tax Compliance Act, due to the similarities between the two and attending to its goal to create a global standard for the automatic exchange of information for tax purposes.<sup>100</sup>

Whilst the CRS was indeed based on the intergovernmental agreements drafted for FATCA purposes,<sup>101</sup> there are several key differences that separate the two.

Firstly, FATCA was initially conceived as a unilateral regulation, meant to pressure financial institutions into reporting the movements of foreign accounts held by U.S. taxpayers. The transnational nature of the regulation was only contemplated

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<sup>99</sup> Presidência do Conselho de Ministros. “Proposta de Lei 11/XIV”. <https://www.parlamento.pt/ActividadeParlamentar/Paginas/DetalleIniciativa.aspx?BID=44417>

<sup>100</sup> “OECD Common Reporting Standard: A global FATCA-like regime”. *International Tax Alert* (18/02/2014). [https://www.ey.com/Publication/vwLUAssets/EY\\_-\\_OECD\\_Common\\_Reporting\\_Standard:\\_A\\_global\\_FATCA-like\\_regime/\\$FILE/EY-Client-alert-](https://www.ey.com/Publication/vwLUAssets/EY_-_OECD_Common_Reporting_Standard:_A_global_FATCA-like_regime/$FILE/EY-Client-alert-OECD-Common-Reporting-Standard.pdf)

[OECD-Common-Reporting-Standard.pdf](https://www.ey.com/Publication/vwLUAssets/EY_-_OECD_Common_Reporting_Standard:_A_global_FATCA-like_regime/$FILE/EY-Client-alert-OECD-Common-Reporting-Standard.pdf)

<sup>101</sup> Ibid. 79

due to conflicts between the reporting requirements and the domestic law of some foreign countries, which hindered the compliance of financial institutions with the regulation.<sup>102</sup> Conversely, the CRS was created specifically as a multilateral standard to be implemented globally. Additionally, whereas under FATCA participating financial institutions have to report directly to the IRS, there is no cross-borders reporting provision in the CRS as financial institutions have to report to their local tax authority.

One of the most glaring distinctions between both regulations concerns the withholding tax, which is the main tool used by the FATCA regulation to ensure compliance from foreign financial institutions. This concept is completely absent from the CRS, which has led to some controversies amongst the commentariat, mainly due to the fact that the United States, home to several OFCs, did not commit to implementing the CRS, instead choosing to benefit from a significant imbalance in reporting requirements. Whilst the IGAs are reciprocal to some degree, foreign financial institutions are generally required to report a larger amount of information and are the only ones subject to sanctions in case of non-compliance.<sup>103</sup> This disparity is apparent in the IGA Model 1 concluded between the United States and the Republic of Portugal, in which Portuguese financial institutions are not only required to report U.S. Account Holders, but U.S. Controlling Persons of a Non-U.S. Entity as well. In the case of the United States, the reporting only centres on any Account Holder that is an individual resident of Portugal, and the amount of information to be divulged is much more limited.<sup>104</sup> Thus, U.S. financial institutions will not report any information regarding any type of account held by an Entity or by a Non-Portuguese Entity with Portuguese Controlling Persons. In contrast, the CRS is fully reciprocal unless the

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<sup>102</sup> PARADA, Leopoldo. “Intergovernmental Agreements and the Implementation of FATCA in Europe”. *World Tax Journal*, 2015 (Vol. 7), No 2. (24/06/2015).

<sup>103</sup> “Why Europe should impose withholding taxes on payments, to crack open secretive tax havens”. *Tax Justice Network* (21/01/2016). <http://www.taxjustice.net/wp-content/uploads/2013/04/TJN2016-WithholdingTax.pdf>

<sup>104</sup> *Ibid.* 71, article 2(2).



chosen agreement between two jurisdictions is specifically non-reciprocal (e.g. for jurisdictions with no income tax).<sup>105</sup>

Other dissimilarities concern the distinction between U.S. Persons (classification based on nationality) and Reportable Persons (classification based on tax residence), the type of documentation required from the client in order to classify them (U.S. tax documents versus a Self-Certification), the scope of information required from the client (in the case of the CRS, the tax residence and place of birth are additional requirements), the distinction made between beneficial owners and controlling persons (controlling persons may include senior managers, and the term only applies in IGAs and in the CRS) and the registration requirements for reporting financial institutions (FFIs have to register with the IRS whilst no such registration system exist under the CRS).<sup>106</sup>

Finally, the identification and classification of accounts differs from FATCA to CRS. Whereas under the CRS, the date from which accounts are considered new depends on the date at which the jurisdiction started exchanging information (January 1<sup>st</sup>, 2016, for early adopters), under FATCA new accounts are invariably the ones opened from July 1<sup>st</sup>, 2014, the day the regulation came into effect. In regards to the identification of new and pre-existing individual accounts, the CRS does not consider any *de minimis* reporting threshold, meaning all new and pre-existing individual accounts need to be reviewed.<sup>107</sup> Under FATCA, there is generally a *de minimis* threshold of \$50,000, except with regards to pre-existing individual account for cash value insurance or annuity contract, for which the *de minimis* threshold is \$250,000. The FATCA provision for pre-existing individual accounts ceases to apply if the account balance or

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<sup>105</sup> OECD. “Commentaries on the Model Competent Authority Agreement” (pp. 65). *OECD Publishing, Paris* (2017). <https://doi.org/10.1787/9789264267992-en>

<sup>106</sup> GLYNN, Laura. “CRS – Implementing Best Practices for Tax Compliance” (pp. 6-7) (2016). <https://www.fenergo.com/resources/whitepapers/crs-implementing-best-practice-for-compliance.html>

<sup>107</sup> Ibid. 88, commentary on section III and IV.

value exceeds \$1,000,000 as of the end of any subsequent calendar year.<sup>108</sup> Under the CRS, an individual pre-existing account does not need to be reviewed, identified, or reported if it is a cash value insurance contract or an annuity contract and the Reporting Financial Institution is prevented by law from selling such contracts to residents of a Reportable Jurisdiction.<sup>109</sup> On the subject of new entity accounts, again, there aren't any *de minimis* reporting threshold with regards to the CRS,<sup>110</sup> as opposed to the \$50,000 *de minimis* reporting threshold of the aggregate balance or value of the account under FATCA. The threshold rises to \$250,000 for pre-existing entity accounts, if no holder of such accounts has been previously identified as a specified U.S. Person. Again, the provision ceases to apply once the aggregate balance or value exceeds \$1,000,000 at the end of any subsequent calendar year.<sup>111</sup> CRS establishes a *de minimis* reporting threshold for pre-existing entity accounts, which are not subject to review if the aggregate account balance or value does not exceed \$250,000 as of the last day of the calendar year.<sup>112</sup> The implementing jurisdiction may, however, opt out of this exception.<sup>113</sup>

Overall, whilst similarities between FATCA and the CRS were inevitable given the effort of the OECD to limit the cost of implementation of the Standard for both jurisdictions and financial institutions, it appears that the CRS is still much broader in scope. Nonetheless, core requirements are sufficiently paralleled that basic due diligence procedures can be harmonised.

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<sup>108</sup> Internal Revenue Service, Treasury. § 1.1471-4 (c)(5)(iii)(A) FFI Agreement. <https://www.govinfo.gov/content/pkg/CFR-2013-title26-vol12/pdf/CFR-2013-title26-vol12-sec1-1471-4.pdf>

<sup>109</sup> Ibid. 88, commentary on section III.

<sup>110</sup> Ibid. 88, commentary on section VI.

<sup>111</sup> Ibid. 108, § 1.1471-4 (c)(3)(iii)(A)

<sup>112</sup> Ibid. 88, commentary on section V.

<sup>113</sup> Ibid. 88, commentary on section V(A).

## Chapter 4

### The Impact on Financial Institutions

This chapter centres around the implications of the shift towards the automatic approach for the exchange of tax information in regards to financial institutions, the burden of implementation of due diligence procedures and the penalties for non-compliance, as well as the review of potential measures that could alleviate the impact.

#### 4.1. Compliance Cost

Any financial institution located in a CRS participating jurisdiction, or any financial institution with connections to the United States market has been impacted by the introduction of FATCA and CRS in the sphere of international taxation. The reporting requirements imposed on these financial institutions called for the implementation of new extensive due diligence procedures, which, at the time, sparked concerns regarding the potential cost of such undertaking. In 2011, the American Citizens Abroad, a non-profit organisation advocating for the rights of U.S. citizens residing outside of the United States, urged Americans to lobby the U.S. Congress for the repeal of FATCA. One of the organisation's concerns was that the costly IRS reporting requirements was causing FFIs to start denying financial services to U.S. clients.<sup>114</sup> The New Zealand Bankers' Association, along with the Australian Bankers' Association and Canadian and British industry groups, opposed the legislation, fearing that the compliance cost could get as high as NZ\$100 million for the New Zealand

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<sup>114</sup> "Americans urged to lobby Congress on FATCA". *International Adviser* (07/09/2011). <https://international-adviser.com/americans-urged-lobby-congress-fatca/>

financial industry.<sup>115</sup> James Broderick, then head of JP Morgan's European, Middle Eastern and African asset management business, estimated that FATCA would cost financial institutions up to \$100 million each, and that the total cost of implementation would be equal to the amount of money FATCA was set to raise in 10 years.<sup>116</sup> Finally, a 2014 survey from Thomson Reuters found that, out of approximately 300 financial institutions, 27% expected that the cost of implementation of due diligence procedures with respect to FATCA would be between \$100,000 and \$1 million, compared to 16% in 2014. This 11% increase demonstrates how the burden of FATCA was initially underestimated by financial institutions.<sup>117</sup> More concretely, the introduction of FATCA is said to have cost Canada's five biggest banks \$693.5 million,<sup>118</sup> whilst the Government of the United Kingdom estimated that the implementation cost of FATCA under its IGA would be up to £1.6 billion for UK financial institutions.<sup>119</sup> In France, the French Banking Federation informed that the cost for French banks was around €200 million, not including recurrent costs which were around 20% of the cost of implementation, nor other types of financial institutions.<sup>120</sup>

A report from the Treasury Inspector General for Tax Administration from 2018 found that the IRS spent \$380 million on the drafting and enactment of FATCA,

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<sup>115</sup> VAUGHAN, Gareth. "NZ banks, fearing NZ\$100 mln bill, work with Australian, Canadian and British on changing 'unworkable' US Foreign Account Tax Compliance Act" (06/09/2011). <https://www.interest.co.nz/news/55211/nz-banks-fearing-nz100-mln-bill-work-australian-canadian-and-british-changing-unworkable>

<sup>116</sup> WOOD, Robert W. "FATCA carries fat price tag". *Forbes* (30/11/2011). <https://www.forbes.com/sites/robertwood/2011/11/30/fatca-carries-fat-price-tag/#4e2c584e4ae9>

<sup>117</sup> "Thomson Reuters Survey Indicates FATCA Compliance to Cost More Than Anticipated". *Global Banking & Finance review* (08/11/2014). <https://www.globalbankingandfinance.com/thomson-reuters-survey-indicates-fatca-compliance-to-cost-more-than-anticipated/>

<sup>118</sup> TRICHUR, Rita. "Canada Banks Tally Their Tax-Compliance Tab". *The Wall Street Journal* (27/07/2014). <https://www.wsj.com/articles/canada-banks-tally-their-tax-compliance-tab-1406504252>

<sup>119</sup> "The cost of complying with FATCA – similar initiatives to follow?". *Herbert Smith Freehills* (03/06/2013). <https://hsfnotes.com/fsrandcorpcrime/2013/06/03/the-cost-of-complying-with-fatca-similar-initiatives-to-follow/>

<sup>120</sup> Sénat, Session Extraordinaire n. ° 751. "Rapport FATCA" (pp. 35) (17/07/2014). <https://www.senat.fr/rap/113-751/113-7511.pdf>

which suggests that the majority of the financial burden of implementing the legislation was borne by FFIs and foreign governments.<sup>121</sup> As a result, some smaller institutions with few American customers opted to close their accounts, in an effort to keep the expenditures down. Such was the case of French-based Axa Bank, which counted with less than 150 American customers. Jean-Marc Vasseux, Risk, Control, and Compliance Director of AXA Banque, explained the decision taken as follows: “Keeping our relationships with [U.S. customers] required heavy adaptations: we therefore chose not to continue. This decision was difficult to make because they were loyal customers.”<sup>122</sup>

As for the costs associated to the implementation of CRS, whilst the standard was based off FATCA as to, in part, minimise compliance costs for financial institutions by allowing them to repurpose their pre-existing processes, the broader scope of the CRS inherently added to the complexity of the infrastructure, driving up the costs of implementation. Supports and procedures had to be reviewed, and new essential trainings had to be deployed. In 2015, the estimated compliance cost impact for Australian financial institutions alone was around \$45 million per year.<sup>123</sup>

## **4.2. Implementation and Current Challenges**

Most financial institutions did not have a system in place to automatically identify certain accounts based on the FATCA and CRS requirements. In January 2013,

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<sup>121</sup> “Despite Spending Nearly \$380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance with the Foreign Account Tax Compliance Act” (05/07/2018). <https://www.treasury.gov/tigta/auditreports/2018reports/201830040fr.pdf>

<sup>122</sup> Finance Committee Report. “Implications for France of the American “FATCA” legislation and prospects regarding the development of the automatic exchange of information in tax matters” (12/02/2014). <http://www.senat.fr/compte-rendu-commissions/20140210/fin.html#toc6>

<sup>123</sup> The Parliament of the Commonwealth of Australia, House of Representatives. “Tax Laws Amendment (Implementation of the Common Reporting Standard) Bill 2015: Explanatory Memorandum”. <https://www.legislation.gov.au/Details/C2015B00229/Explanatory%20Memorandum/Text>

a research showed that 65% of financial institutions were struggling to meet FATCA client identification requirements due to infrastructure deficiencies.<sup>124</sup> Another survey from 2012 found that the main compliance challenge for FATCA implementation would lie with the account identification requirements, followed by documentation requirements and system changes.<sup>125</sup> The absence of reporting threshold and the multilateralism of the CRS translated into the obligation to review what could amount to thousands of accounts spanning several jurisdictions, depending on the financial institution. The information to be reviewed and reported is generally not centralised in one business segment, meaning that financial institutions had to plan an important restructuring permitting the collection of such information in an efficient manner. In a survey from 2016, 62% of 80 financial institutions reported not having the necessary software solutions in place to meet FATCA and CRS requirements.<sup>126</sup> The complexity of implementation also varies depending on the number of jurisdictions in which a financial institution operates, as the requirements for both FATCA and CRS differ from jurisdiction to jurisdiction, in which case procedures have to be adapted in order to ensure the correct classification and reporting of accounts. Currently, financial institutions are still facing recurrent expenditures associated with the maintenance of systems and procedures. As the regulations are ever evolving, they must do their utmost to keep their procedures up to date, and plan for further eventual changes.

The client experience was also greatly impacted by the introduction of new legal requirements. The on-boarding processes became much more complex, attending to

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<sup>124</sup> “65% of financial institutions expect FATCA client identification to be moderately or extremely difficult”. *Fenergo* (08/01/2013). <https://www.fenergo.com/company/news/press-releases/65-of-financial-institutions-expect-fatca-client-identification-to-be-moderately-or-extremely-difficult-says-fenergo.html>

<sup>125</sup> “Surveying the market: Are you ready for FATCA?”. *KPMG International* (12/2012). <https://assets.kpmg/content/dam/kpmg/pdf/2013/01/surveying-market-are-you-ready-for-fatca.pdf>

<sup>126</sup> “Thomson Reuters Survey Reveals More than Half of Financial Institutions Are Concerned about Reputational Risks of FATCA & CRS Non-Compliance”. *Thomson Reuters* (31/05/2016). <https://www.thomsonreuters.com/en/press-releases/2016/may/survey-financial-institutions-reputational-risks-fatca-crs.html>

the fact that new clients were required to fill out several additional forms, which can be challenging to comprehend and may require legal assistance. Whilst financial institutions can, to some degree, re-use client data and documentation previously collected, the necessity to identify beneficial owners and controlling persons of some accounts, which is often subject to change, implies that client contact is mostly inevitable. There is sometimes an additional necessity to certify that previously collected information is still valid (e.g. an entity that was classified as an Active NFE can, in some circumstances, become passive by reason of income and assets). Furthermore, if a client maintains several accounts with different institutions or different branches belonging to the same group, it might happen that the client is contacted to answer to different requests for the same documentation, which could lead to client dissatisfaction. Inefficient on-boarding procedures and repeated information requests may equally lead to loss of business,<sup>127</sup> which is why the data and information of each client should be centralised in a database accessible by any relevant player. Such a solution, however, is not simple to implement, partly due to domestic privacy law restrictions.

Financial institutions now have to juggle their customers' rights to privacy and data protection with the expanding scope of data reportable under different regulations. Whilst FATCA and CRS provisions have seriously curtailed the concept of bank secrecy everywhere, privacy and data protection at the European level are seen as fundamental rights. In the European Union, the exchange of information has to comply with the General Data Protection Regulation (EU) 2016/679 (GDPR), and whilst the processing of data is lawful under Article 6 of the regulation, some have argued that the broad requirements imposed by FATCA and CRS do not meet the data minimisation principle defined in Article 5. DAC2 introduces the notion that Reporting

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<sup>127</sup> GLYNN, Laura. "CRS Remediation - Complexity, Cost and Impact on Client Relationships". *Fenergo* (08/2016). <https://www.fenergo.com/resources/blogs/crs-remediation-complexity-cost-and-impact-on-client-relationships.html>

Financial Institutions are considered to be data controllers, and as such have the duty to inform Reportable Persons about the information being collected and transferred pursuant to the Directive. Such information also has to be provided at an early stage, before the data is reported, in order to allow the Reportable Person to exercise their data protection rights.<sup>128</sup> In addition to the duty of informing Reportable Persons and to only retain the collected information for as long as is necessary to achieve the purposes of DAC2, financial institutions have to be extremely careful in the handling of customers data in order to avoid any breach of confidentiality and data protection obligations. Such a breach could lead to customer distrust and reputational damage. Financial institutions therefore have to be mindful of their data protection policy, and reporting mistakes should be avoided at all costs.

Another important hurdle that financial institutions continue to face is the adequate training of employees involved in the identification, reviewing, classification and reporting of each customer account. FATCA and CRS are both very complex regimes, with many specificities and exceptions to be applied depending on the type of account or client and, therefore, ensuring proper compliance inevitably means employees need to be well-informed, kept up to date, and qualified. Mistakes can be costly, and an investment in training would most likely be beneficial in the long run.

### **4.3. The Penalties for Non-Compliance**

As previously reported, if a Foreign Financial Institution, that is not exempt from the registration requirement, chooses not to register with the IRS and comply with FATCA-introduced reporting requirements, the FFI will be subject to a 30% withholding tax on U.S. source payment made to them. If there are omissions or

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<sup>128</sup> Ibid. 82, article 1(5).



inaccuracies in the report of a Reporting Financial Institution, an error notification will provide a certain number of days to fix the issue before the IRS evaluates if there is an issue of significant non-compliance. The penalties for non-compliance by a Reporting Financial Institutions located in a country subject to an IGA may vary depending on each agreement. According to the agreement signed between the United States and Portugal, the competent authorities have to notify each other when a case of non-compliance is identified, and the domestic laws of each country apply. There is an additional provision that if a Portuguese financial institution does not resolve the issue of non-compliance within 18 months after notification, the financial institution will be treated as a Nonparticipating Financial Institution by the United States and will be subject to withholding.<sup>129</sup> In most Model 2 IGA, the financial institution found to be non-compliant is given twelve months after notification to rectify the issue before it is treated as a Nonparticipating FFI.

The non-compliance with the provisions of the CRS vary depending on the jurisdiction. For instance, in the case of Portugal, Article 5 of the Decree-Law n.º 64/2016, which amends Article 7(C) of the Decree-Law n.º 61/2013, of May 10, stipulates the consequences of failure to comply with legal obligations by financial institutions. If there are omissions or inaccuracies in the information communicated to the Tax Authority, the financial institution will be notified through a new communication. If there is a case of non-compliance with the provisions of the Decree-Law, the financial institution will equally be notified by the Tax Authority, and asked to correct or supply the missing information, or to adopt or correct its due diligence procedures. In any case, or if there is an event of non-compliance with the obligation to maintain registration with the Tax Authority, the financial institution shall be subject to the penalties set forth in the General Regime of Tax Infractions,<sup>130</sup> approved by Law

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<sup>129</sup> Ibid. 71, article 5(2).

<sup>130</sup> Ibid. 57, Article 7(C).

n.º 15/2001, of June 5, which can amount to €45,000 in case of negligence or to €165,000 in case of intent.<sup>131</sup>

Despite the challenges introduced by the necessity for financial institutions to comply with FATCA and CRS reporting requirements, non-compliance is rarely a viable option, as the consequences would be quite significant.

#### **4.4. Methods to Mitigate the Impact**

The biggest impact financial institutions have to mitigate, in regards to FATCA and CRS requirements, is the increase in expenditures. The only apparent method to avoid such increase is by either restricting some accounts with regards to American citizens, which won't be as effective now that the CRS introduced broader reporting requirements, or by being compliant. It is important that any financial institution looking to be compliant starts by investing in specialists. The practical implementation of FATCA and CRS is complex, and a detailed understanding of both regulations is paramount in order to avoid wasting time or resources. The main objective should be implementing a system that is functional and efficient from the beginning, as there are many business segments that need to interact with each other and if not properly harmonised, it could lead to errors in the identification, classification and reporting of clients that would be costly to fix. It is more and more evident that a fragmented system can lead to errors, delays, and overall client dissatisfaction, especially if they are being solicited by different segments of the same entity. There are no one-size-fits-all approach that don't involve some kind of internal restructuring; however, some financial institutions have resorted to employ an external software provider to manage

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<sup>131</sup> Assembleia Da República, artigo 26.º da Lei n.º 15/2001 de 5 de Junho (amended by Lei n.º 64-B/2011, de 30 de Dezembro). *Diário Da República — I Série-A N.º 130 — 5 de Junho de 2001* <https://dre.pt/application/conteudo/322110>

the client lifecycle whilst ensuring regulatory compliance. In a time where financial regulatory requirements of all kind keep rising, and financial institutions' business lines are still lacking interconnectivity, client lifecycle management has become a logistical nightmare. Owing to that, new financial technologies and regulatory technologies are starting to populate the landscape of the financial sector, allowing for the digitalisation of manual processes that burdened back and middle office operations.<sup>132</sup>

Conclusively, financial institutions should opt for a combination of several solutions to mitigate the impact of new regulatory requirements, ranging from the proper training of employees to the centralisation of documentation and data (in as few segments as possible whilst complying with data privacy laws) and the automation of screenings and data management.

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<sup>132</sup> GUPTA, Pranay and THAM, T. Mandy. "Fintech: The New DNA of Financial Services" (pp. 396-418). *Walter de Gruyter GmbH & Co KG* (2018).



## Chapter 5

### The Present and Future of FATCA and CRS

This chapter reviews the latest developments regarding FATCA and CRS and aims to identify current potential issues, as well as to take a look at the next challenges which will have to be undertaken.

#### 5.1. Current Situation

The start of the automatic exchange of information under the CRS is quite recent, having begun in 2017 for the early adopters, and the Global Forum intended to conduct peer reviews regarding the effectiveness of its implementation during 2020. However, in total, from January to November 2019, around 6,100 bilateral exchanges were made between the 94 jurisdictions exchanging information, which is 36% more than in 2018.<sup>133</sup> As of June 2020, over 100 jurisdictions have committed to implement or have implemented the CRS. That is already a huge accomplishment that would have seemed impossible to achieve a decade ago, mainly due to the fact that it appeared OFCs would never cooperate on the matter. Today, most OFCs and conduit-OFCs (i.e. jurisdiction through which a disproportional amount of value moves toward OFCs) identified by the University of Amsterdam's OFC Meter<sup>134</sup> are participating in the automatic exchange of information for tax purposes.

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<sup>133</sup> Ibid. 86

<sup>134</sup> GARCIA-BERNARDO, Javier, et al. "Financial Centers: Conduits and Sinks in the Global Corporate Ownership Network", *Scientific Reports* 7, article 6246, (2017). <https://www.nature.com/articles/s41598-017-06322-9.pdf>. OFC Meter. <https://www.ofcmeter.org/>

Nevertheless, the regulation is not perfect, and a 2018 Report commissioned by the Greens/EFA Group in the European Parliament<sup>135</sup> shows that there are still some loopholes that need to be addressed. A revision of DAC2 and, by extension, of the CRS found that the enforcement of the regulation was insufficient, due mainly to the lack of sanctions for OFCs that choose to simply abstain from the exchange of information with selected countries. Secondly, the “golden visa” system<sup>136</sup> was found to facilitate tax avoidance schemes by circumventing the tax residence approach to identification of reportable persons, as defined in the CRS, through the misrepresentation of a golden visa holder’s tax residence and thus sending the financial accounts information to the jurisdiction issuing the golden visa. If a person obtains a golden visa in an OFC with no income tax, which has opted to enforce non-reciprocal bilateral agreements (according to which the OFC has to share information but does not receive it), the information regarding any of their accounts will not be subject to reporting. In response to this issue, the OECD released a list of 20 countries with “potentially high-risk” golden visa schemes and published a practical guidance urging financial institutions to request more information from any account holder they might suspect of using a golden visa from one of the listed countries.<sup>137</sup> It is worth noting, however, that only two EU countries were identified (Malta and Cyprus), while a reported 13 EU Member States have such a system in place. There are also still many financial entities that are not targeted by the regulation, and the information being exchanged can only be used for taxes purposes, due to privacy concerns.

As for FATCA, 113 jurisdictions currently have agreed to a Model 1 or Model 2 IGA and more than 350,000 financial institutions are registered with the IRS.

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<sup>135</sup> KNOBEL, Andres. “Reporting taxation: Analysing loopholes in the EU’s automatic exchange of information and how to close them” (15/10/2018). <http://extranet.greens-efa-service.eu/public/media/file/1/5729>

<sup>136</sup> A residency-by-investment system allowing foreign citizens to make a qualifying investment in a jurisdiction and thereby be granted a residence permit from such jurisdiction.

<sup>137</sup> Ibid. 95

However, a 2018 report<sup>138</sup> showed that very little had been done by the IRS to ensure compliance with FATCA. The main problem seemed to be in regards of the lack of TINs in many forms, which, as analysed before, is an issue that still remains unsolved.

The United States also has yet to commit to the CRS, and remains unwilling to do so. After essentially coercing OFCs and many foreign countries to comply with FATCA through the use of threats of significant financial penalties, the U.S. now enjoys a special status allowing it to receive financial information on all its citizens and green card holders whilst giving no or very limited information to other countries. As observed by the commentariat, the U.S. has, in a way, positioned itself to become the world's tax haven.<sup>139</sup> The situation was acknowledged by the United States government, with the Department of the Treasury addressing a letter to the House of Representatives in 2016 in which he urges: "Reciprocity with other jurisdictions is a key component of any successful strategy for combatting international tax evasion".<sup>140</sup> In order for the U.S. to agree to such exchanges it would first have to introduce new laws requesting more ample information from its financial institutions. However, a 2019 report from the Government Accountability Office (GAO) advises against the commitment to the CRS by the United States, with the following statement: "While better aligning FATCA and CRS to some extent is possible, anything short of the United States fully adopting CRS would not fully eliminate the burdens of overlapping requirements that FFIs must currently meet under the two different systems. While having the United States adopt the CRS reporting system in lieu of FATCA could benefit FFIs that may otherwise have to operate two overlapping reporting systems, it

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<sup>138</sup> Ibid. 121

<sup>139</sup> "The U.S. Is Becoming the World's New Tax Haven" (28/12/2017). *Bloomberg*. <https://www.bloomberg.com/opinion/articles/2017-12-28/the-u-s-is-becoming-the-world-s-new-tax-haven>

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<sup>140</sup> "Lew to Ryan on CDD" (05/05/2016). <https://www.treasury.gov/press-center/press-releases/Documents/Lew%20to%20Ryan%20on%20CDD.PDF>

would result in no additional benefit to IRS in terms of obtaining information on U.S. accounts. Additionally, it could generate additional costs and reporting burdens to U.S. financial institutions that would need to implement systems to meet CRS requirements. The extent of these costs is unknown. Further, adoption of CRS would create the circumstance where foreign accounts held by U.S. citizens with a tax residence in partner jurisdiction—including U.S. citizens who have a U.S. tax obligation—would not be reported to IRS”.<sup>141</sup> The concern regarding the lack of reporting of U.S. citizens with a tax residence in a partner jurisdiction is, however, a misconception, as the CRS Implementation Handbook clearly states: “Since under US tax law a US citizen is also a US tax resident, the Model 1 FATCA IGA provides that both US citizens and US residents are included in the definition of US person [...]. The approach taken in the Standard definition generally determines residence under the tax laws of a Reportable Jurisdiction. Because in the case of the US, a US tax resident includes a US citizen and a US resident, the approach in the Model 1 FATCA IGA is consistent with the Standard [...]”.<sup>142</sup> In short, the United States’ choice not to adopt the CRS is a purely political one. There were some reports that the European Union would add the United States to its 2019 blacklist of tax havens,<sup>143</sup> allowing Member States to take “effective and proportionate defensive measures”,<sup>144</sup> but as of June 2020, such decision has yet to be taken.

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<sup>141</sup> GAO. “Foreign Asset Reporting: Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad”. *GAO-19-180* (04/2019). <https://www.gao.gov/assets/700/698133.pdf>

<sup>142</sup> OECD. “Standard for Automatic Exchange of Financial Account Information in Tax Matters: Implementation Handbook”, (pp. 134). *OECD Publishing, Paris* (2017). <https://www.oecd.org/tax/exchange-of-tax-information/implementation-handbook-standard-for-automatic-exchange-of-financial-information-in-tax-matters.pdf>

<sup>143</sup> KIRWIN, Joe. “EU’s Expanded Tax Haven Blacklist Could Apply to U.S.”. *Bloomberg Tax* (13/12/2018). <https://news.bloombergtax.com/daily-tax-report-international/eus-expanded-tax-haven-blacklist-could-apply-to-us-1>

<sup>144</sup> Council of the European Union (05/12/2017). “The EU list of non-cooperative jurisdictions for tax purposes: Council conclusions”, (pp. 5). *Official Journal, ST 15429 2017 INIT*. <https://data.consilium.europa.eu/doc/document/ST-15429-2017-INIT/en/pdf>



## 5.2. Next Challenges

Whilst the progress in matters of international tax cooperation and transparency has been noteworthy, much remains to be done. Indeed, as noted by economist Gabriel Zucman, for the automatic exchange of information to be truly effective in combatting tax evasion and tax avoidance, it invariably needs to be global, otherwise tax evaders will simply transfer their assets to another OFC.<sup>145</sup> To that end, the EU and OECD tax havens blacklists' criteria need to be amended in order to set any political consideration aside. It is no coincidence that the Cayman Islands were only classified as a non-cooperative jurisdiction by the EU in the wake of Brexit,<sup>146</sup> and the Tax Justice Network has previously accused the OECD of electing its criteria carefully in favour of the U.S. secrecy framework.<sup>147</sup> According to the Financial Secrecy Index created by the Tax Justice Network, which takes secrecy and offshore financial activities into account, the U.S. is the second worst offender, whilst Switzerland, Luxembourg, the Netherlands, the United Kingdom and Germany all figure in the top 15. The United Kingdom would take first place if it were considered one single entity along with its overseas territories and crown dependencies, of which three are also in the top 15, with the Cayman Islands coming in number 1.<sup>148</sup>

The second step in promoting the effectiveness of the automatic exchange of financial accounts information is the introduction of sanctions on non-cooperative

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<sup>145</sup> ZUCMAN, Gabriel. "Taxing across Borders: Tracking Personal Wealth and Corporate Profits", (pp. 144). *Journal of Economic Perspectives—Volume 28, Number 4—Fall 2014—Pages 121–148* (2014).

<sup>146</sup> BOFFEY, Daniel. "In wake of Brexit, EU to put Cayman Islands on tax haven blacklist". *The Guardian* (13/02/2020). <https://www.theguardian.com/us-news/2020/feb/13/eu-to-put-cayman-islands-on-tax-haven-blacklist>

<sup>147</sup> KNOBEL, Andres. "Blacklist, whitewashed: How the OECD bent its rules to help tax haven USA". *Tax Justice Network* (27/07/2018). <https://www.taxjustice.net/2018/07/27/blacklist-whitewashed-how-the-oecd-bent-its-rules-to-help-tax-haven-usa/>

<sup>148</sup> Tax Justice Network Financial Secrecy Index (2020) <https://fsi.taxjustice.net/en/introduction/fsi-results>.

OFCs and the establishment of a reward system for whistle-blowers, at the global level. This will somewhat prevent corruption and encourage compliance. Moreover, the current loopholes identified regarding the CRS must be solved, as they currently undermine the purpose of the regulation.

Finally, as of June 2020, 45 developing countries having committed to the automatic exchange of information still haven't set a date for the first exchange. This is mostly due to the fact that bilateral and multilateral agreements under the CRS require the reciprocal exchange of information, and that most developing countries lack the internal infrastructure needed to be able to meet reporting requirements. While the Global Forum did draft a Plan of Action<sup>149</sup> in 2017 for the participation of developing countries in AEOI, in which it is acknowledged that developing countries are highly affected by issues of tax avoidance and tax evasion, the assistance provided so far appears insufficient. For example, Isabel dos Santos, daughter of Angola's former president and Africa's richest woman, who has been one of the targets of a campaign to root out corruption, has recently been accused of taking advantage of the U.S. secrecy framework to hide her assets.<sup>150</sup> As it was estimated that, in 2016, 44% of Africa's financial wealth was held offshore, this kind of illicit practices are draining poorer countries and slowing their development.<sup>151</sup> In the pursuit of a fair and transparent international tax landscape, it is paramount that developing countries be afforded the same opportunities with regards to the automatic exchange of financial accounts information.

The OECD should strive to fortify the current regulations in place and promote their implementation on a global level if it is to be fully efficient.

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<sup>149</sup> OECD. "The Global Forum's Plan of Action for Developing Countries Participation in AEOI" (11/2017). <https://www.oecd.org/tax/transparency/plan-of-action-AEOI-and-developing-countries.pdf>

<sup>150</sup> SULEYMANOVA, Ramlila. "Hiding money: US is a major hub of financial secrecy, says report". *Aljazeera* (18/02/2020). <https://www.aljazeera.com/ajimpact/hiding-money-major-hub-financial-secrecy-report-200217165131298.html>

<sup>151</sup> Ibid. 5

## **Chapter 6**

### **Conclusion**

The aim of this dissertation was to analyse the automatic exchange of information through the FATCA and CRS regulations and assess their impact on financial institutions. Whilst it is too early to draw conclusions regarding the potential positive repercussions the introduction of both regulations had on the global loss of revenue occasioned by tax non-compliance, the impact on financial institutions was immediate and of much importance.

FATCA, as the first regulation to be enacted, resulted in ample compliance costs due to the necessity for restructuring and the implementation of new systems. The CRS, being broader in its scope, had similar repercussions. However, the concurrent managing of two different types of reporting requirements, even if overlapping, signifies a greater burden for financial institutions and, as exposed in the previous chapter, there doesn't appear to be any legitimate justification as to why FATCA shouldn't be repealed. While both regulations diverge in some regards, it is mainly due to the wider, multilateral application of the CRS, and not due to its more restrictive nature. The 2019 report from GAO worries about the potential cost for U.S. FIs if the United States were to adopt the CRS, but such position seems extremely dishonest as the United States pressured foreign financial institutions to bear the majority of the cost resulting from FATCA. By mentioning that the adoption of the CRS would result in no "additional benefit to IRS in terms of obtaining information on U.S. accounts", the report blatantly disregards the benefit that it would represent for other countries, with which it would exchange on a basis of reciprocity. Moreover, it overlooks the commitment made by the United States in the intergovernmental agreements to

“[pursue] the adoption of regulations and [advocate] and [support] relevant legislation to achieve [...] equivalent levels of reciprocal automatic information exchange”.

For the impact of FATCA and CRS on financial institutions to be justifiable, the regulations in place must be effective. By now, it is evident that FATCA, while promoting pseudo-multilateralism through the conclusion of intergovernmental agreements, remains a unilateral legislation. Yet, as previously mentioned, for the automatic exchange of financial account information to be successful it has to be implemented globally. The current inequality between the United States and the rest of the world is therefore unsustainable, as the U.S. has currently positioned itself as the world's tax haven, and should be addressed by the European Union and by the OECD.

Ideally, the Common Reporting Standard should be the only standard implemented globally, so that the impact on financial institutions can be mitigated and global tax transparency optimised.

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