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ARTICLE

Exchanges of Information: What Does the IRS Receive? With Whom Does the IRS Speak?

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The U.S. government receives significant amounts of information regarding non-U.S. financial institutions, their U.S. customers, and schemes to assist those customers in avoiding taxation. Whether the information is received through domestic law, the offshore voluntary disclosure programs, income tax treaties, tax information exchange agreements, or in the future, FATCA, the data is voluminous and its content sheds light on information that is of interest to tax authorities in other jurisdictions. The global financial community has accepted information transparency with the U.S., it is not clear that the information will stop with the Internal Revenue Service (IRS). Indeed, the infrastructure exists for the IRS to be a conduit of information to tax authorities around the world. This article explores the ways in which information is submitted to the IRS and the avenues available to the IRS to transfer the information to tax authorities in other jurisdictions.

1 Exchange of information under treaties

There has been a long tradition against enforcing collection of tax of one jurisdiction in another jurisdiction. Historically, it comes from common law, where in 1775, in an action for the enforcement of a contract, Lord Mansfield famously formulated the rule as, "… no country ever takes notice of the revenue laws of another."[1] This law has been used many times to avoid enforcement of one state's tax law in another jurisdiction.[2]

But many changes have developed in tax law, especially since 2010. The first double taxation treaty was enacted between the United States and France; in 1932, the treaty contained provisions relieving double taxation but did not provide for an exchange of information. The first exchange of information language was included in the 1939 treaty between the United States and Sweden.[3] The exchange of information provisions are now included in all double tax conventions to which the United State is a party. Changes in recent years – partly due to the prosecution of UBS AG, the global financial crisis, and the general increase in globalization – created an international consensus for bank transparency in support of tax compliance.[4] The United States Model Tax Treaty contains provisions addressing the scope of the information that can be exchanged between treaty countries.[5] In addition, it establishes whether such information is necessary to carry out provisions of the treaty or of the countries' domestic laws. The "competent authority" referred to in the Model Treaty is designated by each country to request and receive information.

Information received under the exchange of information articles of an income tax treaty is protected by the confidentiality clause contained in the treaty. Under this clause, information received is treated as secret in the same manner as the information obtained under domestic laws.[6]

Today, as a result of state-to-state negotiations, there are more than fifty Mutual Legal Assistance Treaties ("MLAT") with the United States. The degree of governmental access to financial information has varied from country to country, ranging from the relative transparency in the United States to the traditional opacity of jurisdictions such as Switzerland and Liechtenstein.[7] The MLAT seeks to facilitate the exchange of information and evidence in criminal investigations and prosecutions. Each country designates a central authority for direct communication; in the United States it is usually the Justice Department. The treaties include power to

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1 *Holman v. Johnson*, 98 Eng. Rep. 1120 (K.B.) (1775).

2 *Ludlow v. Van Rensselaer*, 1 Johns. 93 (N.Y. 1806). *Government of India v. Taylor* AC 491 (1955).

3 New treaty was signed on Sep. 1, 1994, and replaced an income tax treaty between the two countries that was signed in 1939, and amended by a supplementary protocol signed in 1963. The Tax Treaty of 1994 was subsequently amended in 2005.

4 2014 TNT 39-28.

5 Article 26 of the U.S. Model Treaty.

6 U.S. Model Treaty Art. 26.

7 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14).

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summon witnesses, compel production of documents and other real evidence, to issue warrants and to serve process.

In addition to exchange of information articles in tax treaties, there are Tax Information Exchange Agreements ("TIEAs") entered into between the United States and other countries. Also, information can be exchanged pursuant to the Convention on Mutual Administrative Assistance in Tax Matters, which was developed by the Council of Europe and the Organization for Economic Cooperation and Development ("OECD").

Beginning in the 1980s, the United States entered into TIEAs with an objective of promoting international cooperation in civil or criminal tax matters through exchanges of information.[8] TIEAs are executive agreements entered into by the Treasury Department and accordingly the consent of the Senate is not a prerequisite for implementation.[9] The goals of the United States under this tax exchange program are:

(a) The accurate assessment and collection of taxes;

(b) Prevention of fraud and tax evasion; and

(c) Development of improved sources for the collection of tax information.

TIEAs are more specialized and effective then tax treaties, because they specifically provide for mutual assistance in civil and criminal tax investigations and proceedings. When a jurisdiction enters into a TIEA, it must have adequate process to obtain information. If necessary procedures are not in place, the enactment of legislation is required to provide such assistance. Enforcement of a TIEA is delayed until each party entering into the agreement meets its requirements.[10]

Both, TIEAs and MLATs require that the United States and its treaty partners designate and authorize an entity within their respective governments to interpret agreement provisions and disclose information.

The OECD Model Tax Convention also permits disclosure of information to oversight authorities.[11] The amendments in the proposed protocol to the Multilateral Convention on Mutual Administrative Assistance address the confidentiality of the information provided by the signatory state. This proposed protocol brings the existing multilateral convention into the conformity with the OECD standards on transparency and effective exchange of information.[12] The proposed protocol strengthens the confidentiality requirements to protect personal data provided by a signatory state. It provides that any information exchanged under the treaty may be disclosed in public court proceedings or judicial opinions without need for consent of the party supplying the information.

The revised protocol adds additional safeguards. To illustrate, it permits the treaty country supplying the information to specify additional safeguards that must be followed to ensure the security of any personal data so exchanged.[13] The general rule is that country requesting the information must protect the information it receives as secret information under its own domestic law.[14] Any measures specified by a treaty country must be consistent with safeguards applicable under its own domestic laws. The United States will not provide information to a country unless the country submitting a request observes the secrecy obligations of the treaty it signed with the United States and any additional safeguards necessary to ensure a level of data protection similar to that available under U.S. confidentiality laws.[15]

Many countries have poor reputations for protecting confidential information obtained from foreign governments. Robert Stack, Treasury Deputy Assistant Secretary, testified that there are procedures in place in the U.S. Treasury Department to ensure the confidentiality and appropriate use of information exchanged under the proposed protocol to the Mutual Convention on Mutual Administrative Assistance in Tax Matters.[16] Before a country can become a signatory, the potential signatory country's domestic laws and its practice are examined to determine if it would be able to fulfill its obligation under the convention.[17] Once a country is approved and becomes a signatory, it is required to abide by the convention's confidentiality rule. In addition, the Internal Revenue Service (the "IRS") will monitor the process; in case there is a breach of confidence, the IRS will withhold the information until the problem is resolved.[18]

The IRS looks into the each case to determine if there is an actual ongoing audit or if the request is "a fishing expedition." Only after its investigation into domestic

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8 *Ibid*.

9 *Ibid*.

10 *Ibid*.

11 Organization for Economic Development and Co-operation Model Tax Convention, Art. 26.

12 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14).

13 Organization for Economic Development and Cooperation Model Tax Convention, Art. 22.

14 *Ibid*.

15 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14).

16 2014 TNT 39-11.

17 *Ibid*.

18 *Ibid*.

practices of the requesting jurisdiction indicates that confidentiality is respected and enforced will the IRS transmit the taxpayer information. If the IRS is not convinced about the true nature of the request it will decline to hand over the requested information.[19]

Under most bilateral treaties, the Competent Authority[20] is responsible for exchanges of information and their security under the domestic law of the other state.[21] The information received by the United States is within the scope of "tax convention information"[22] and if the information is taxpayer specific it is treated as "return information"[23] for purposes of preventing unauthorized disclosure.[24] Even information that is non-taxpayer specific will be considered tax convention information and is protected from disclosure, when such disclosure would harm tax administration.[25]

In addition to treaty protection, confidentiality provisions of IRC section 6103[26] cover tax return information and IRC section 6105[27] provides that information received pursuant to a tax convention can only be disclosed as provided in such convention. Taxpayer-specific information that relates to the existence or possible existence of the tax liability, penalty, interest, fine, forfeiture, or other imposition or offence under the code is return information[28] and also an agreement pursuant to a tax convention.[29]

2 Domestic law of the united states

Returns and return information are confidential and cannot be disclosed except as authorized by government personal and other specified persons.[30] A "return" is defined as any tax return or information return, declaration of estimated tax, or claim for refund or any amendment or supplement thereto, including supporting schedules, attachments, or lists which are supplemental to, or part of, the return so filed.[31]

"Return information" is very broadly construed and covers all information pertaining to a taxpayer in the possession of the IRS, which includes: the taxpayer's income or wealth, assets or liabilities, tax liabilities or payments, tax items, or any other data pertaining to the determination of the taxpayer's tax liabilities.[32]

Disclosure of information is permitted in specified circumstances[33] and numerous exceptions exist where returns and return information can be disclosed. To illustrate, the IRS may disclose tax returns or return information to a designee of the taxpayer unless such disclosure would seriously impair Federal tax administration.[34] The request for disclosure or consent to disclosure "must be in the form of a separate written document pertaining solely to the disclosure," the written document must be signed and dated by the taxpayer, must provide certain specific information (including the taxpayer's identity information and the identity of the person(s) to whom the disclosure will be made), and must be received by the IRS within 120 days of the date on which the document was signed.[35] Forms 2848 or 8821 may be used for this purpose.[36]

In some circumstances, the IRS may disclose returns and return information to state and local law enforcement agencies.[37] The confidential tax information may be released to "any State agency, body, or commission, or its legal representative, which is charged . . . with responsibility for the administration of State tax laws for the purpose of, and only to the extent necessary in, the

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19 *Ibid.*

20 The Secretary of the Treasury has delegated the role of U.S. Competent Authority for the treaties to the Deputy Commissioner (International), LB&I, of the IRS.

21 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14).

22 26 U.S.C. s. 6105(c)(1) of the Internal Revenue Code of 1986 as amended (hereinafter referred as I.R.C.).

23 I.R.C. s. 6103(a)(2).

24 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14).

25 Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual Administration in Tax Matter, JCT Report (JXC-9-14), I.R.C. s. 6105.

26 I.R.C. s. 6103.

27 I.R.C. s. 6105.

28 I.R.C. s. 6103.

29 I.R.C. s. 6105.

30 I.R.C. s. 6103.

31 I.R.C. s. 6103(b).

32 I.R.C. s. 6105.

33 I.R.C. s. 6103(d), (f)-(h), (k).

34 I.R.C. s. 6103(c).

35 Regulations s. 301.6103(c)-1(b)(1)-(2), s. 301.6103(f), as amended by T.D. 9618, 78 Fed. Reg. 10738 (5/6/13) (120-day period is effective for authorizations signed after Oct. 9, 2009).

36 IRM 11.3.3.1.1. (Mar. 18, 2008).

37 I.R.C. s. 6103(d).

administration of such laws."[38] Confidential tax information may not be released to state employees that are not representatives of the authorized agencies. In particular, the chief executive of a state does not meet this criteria and may not receive returns or return information.[39]

Disclosure is also permitted to the person having material interest.[40] When a return is filed by an individual, the return may be disclosed to the individual[41] or the spouse or child of the individual (under certain circumstances). If a return is filed jointly, the return may be disclosed to either of the individuals to whom the return pertains.[42] A partnership return may be disclosed to any person who was a member of the partnership during the period covered by the return.[43] The return of a corporation or any corporate subsidiary may be disclosed to: (i) any person designated by the board of directors; (ii) officers or employees upon a written request signed by the principal officer and attested to by the secretary; and (iii) any bona fide shareholder of record owning 1% or more of the outstanding common stock.[44]

Disclosure is also permitted for purposes of tax administration.[45] Returns and return information "shall, without written request, be open to inspection by or disclosure to officers and employees of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes."[46] Rules governing disclosure of information to the Department of Justice ("DOJ") are more complicated.[47] The DOJ officer or employee must be personally and directly involved in the matter. Disclosure to the DOJ is also permitted where the matter has been referred to the DOJ or in some circumstance the disclosure is solely for use in a proceeding before a Federal grand jury or in preparation for any proceeding (or investigation which may result in such a proceeding) before a Federal grand jury or any Federal or state court.[48]

Returns and return information may be disclosed in a Federal or state judicial or administrative proceeding pertaining to tax administration under the following circumstances:

(a) The taxpayer is a party to the proceeding, or the proceeding arose out of, or in connection with, the taxpayer's civil or criminal liability, or the collection of such civil liability;

(b) The treatment of an item reflected on such return is directly related to the resolution of an issue in the proceeding;

(c) The information disclosed is directly related to a transactional relationship between a person who is a party to the proceeding and the taxpayer and that relationship directly affects the resolution of an issue in the proceeding; or

(d) The information is required to be disclosed by order of a court pursuant to 18 USC section 3500 or Rule 16 of the Federal Rules of Criminal Procedure.[49] But this information may not be disclosed if the Secretary determines that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation.[50]

There are civil and criminal penalties for violation of section 6103.[51] A taxpayer may sue In a Federal District Court to recover civil damages from the United States if a return or return information is knowingly or negligently "inspected" or disclosed by an employee or officer of the United States in violation of section 6103.[52] The Code provides the right to sue any other person for civil damages in a Federal District Court if a taxpayer's return or return information is knowingly or negligently "inspected" or disclosed by that person in violation of

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38 I.R.C. s. 6103(d)(1).

39 I.R.C. s. 6103(d)(1).

40 I.R.C. s. 6103(e).

41 Taxpayers may request copies of their tax returns by filing Form 4506, or may request copies of tax return transcripts, records of account, W-2s, and 1099s by filing Form 4506-T.

42 I.R.C. s. 6103(e)(1)(A) and (B).

43 I.R.C. s. 6103(e)(1)(C). See also *Yorkshire v. I.R.S.*, 26 F.3d 942, 947 (9th Cir. 1994); *Martin v. I.R.S.*, 857 F.2d 722, 724 (10th Cir. 1988).

44 I.R.C. s. 6103(e)(1)(D). See also *McAdams v. United States*, 96-1 USTC para. 50,269 (W.D. La. 1996); *Yorkshire v. U.S., ibid*.

45 I.R.C. s. 6103(h)(1), (2) & (3).

46 I.R.C. s. 6103(h)(1).

47 I.R.C. s. 6103(h)(3).

48 I.R.C. ss. 6103(h)(2)(A), 6103(h)(3).

49 I.R.C. s. 6103(h)(4)(A)(D). See IRM 11.3.22.17 (7013-05).

50 I.R.C. s. 6103(h)(4).

51 I.R.C. s. 7431.

52 I.R.C. s. 7431(a)(1).

section 6103 or section 6104(c).[53] But if disclosure was made based upon a good faith, but erroneous, interpretation of section 6103, or was requested by the taxpayer, no right to sue will accrue.[54]

Limitations exist to the amount of damages that may be recovered. The recovery is capped at USD 1,000 per unauthorized inspection or disclosure or the sum of: (i) actual damages sustained by the plaintiff as a result of such unauthorized inspection or disclosure, plus (ii) punitive damages (if the inspection or disclosure was willful or resulted from gross negligence). In addition, the costs of the action and reasonable attorneys' fees may be recovered if the plaintiff is the "prevailing party."[55]

Possible criminal penalties may also be imposed. An unauthorized, willful disclosure of any return or return information constitutes a felony punishable upon conviction by a fine not to exceed USD 5,000 or imprisonment of not more than five years, or both, together with the costs of prosecution. In addition, if the offense is committed by an officer or employee of the United States, that person will also be discharged from employment upon conviction.[56] An anti-browsing statute makes it unlawful to willfully inspect any return or return information, except as authorized.[57] The statute applies to Federal and state employees, and their agents that have access to returns and return information.[58]

Tax convention information cannot be disclosed.[59] The term "tax convention information" means any:

(a) agreement entered into with the competent authority of one or more foreign governments pursuant to a tax convention;

(b) application for relief under a tax convention;

(c) background information related to such agreement or application;

(d) documents implementing such agreement; and

(e) other information exchanged pursuant to a tax convention which is treated as confidential or secret under the tax convention.[60]

The prohibition on disclosure does not apply to:

(a) The disclosure of tax convention information to persons or authorities (including courts and administrative bodies) which are entitled to such disclosure pursuant to a tax convention;

(b) Any generally applicable procedural rules regarding applications for relief under a tax convention;

(c) The disclosure of tax convention information on the same terms as return information may be disclosed, (except that in the case of tax convention information provided by a foreign government, no disclosure may be made under this paragraph without the written consent of the foreign government); or

(d) Any case not described above, with regard to the disclosure of any tax convention information not relating to a particular taxpayer, provided that the IRS determines, after consultation with each other party to the tax convention, that such disclosure would not impair tax administration.[61]

If the release of documents will have an adverse effect on the relationship with the treaty partner, documentation will not be disclosed, because of potential impairment of tax administration. Taxpayer specific information may not be disclosed if the IRS determines that disclosure would not impair tax administration.[62]

Return information, including taxpayer specific information remains subject to confidentiality provision under section 6103, therefore civil and criminal penalties for unauthorized use will apply.[63]

3 Receipt of information under FATCA

To combat tax evasion by United States taxpayers, on March 18, 2010, the Hiring Incentives to Restore Employment Act (the "HIRE Act") of 2010 added Chapter 4 of Subtitle A, comprised of section 1471 through 1474, to the Internal Revenue Code.[64] Chapter 4 is commonly known as the Foreign Account Tax Compliance Act ("FATCA"). FATCA was enacted to reduce tax evasion of U.S. taxpayers by requiring U.S.

Notes

53 I.R.C. s. 7431(a)(2).

54 I.R.C. s. 7431(b).

55 I.R.C. s. 7431(c).

56 I.R.C. s. 7213.

57 I.R.C. s. 7213A(a)(1).

58 Taxpayer Browsing Protection Act, P.L. 105-35 (1997).

59 I.R.C. s. 6105.

60 I.R.C. s. 6105(c)(1).

61 I.R.C. s. 6105(b).

62 Conference Committee Report to P.L. 106-554 (2000), H. R. Conf. Rep. No. 106-1033.

63 I.R.C. s. 7213.

64 Pub. L. 111-147 The HIRE Act. I.R.C. ss. 1471-1474.

withholding of tax on certain payments to foreign financial institutions ("FFIs")[65] that do not agree to report certain information to the IRS regarding their United States investor accounts ("U.S. accounts").[66] Chapter 4 also requires Non-Financial Foreign Entities[67] ("NFFEs") to report information on their substantial U.S. owners. Where noncompliance exists with those reporting obligations, FATCA imposes a 30% withholding tax on FFIs and NFFEs.[68] An FFI may register by filling Form 8957 through the IRS website and may enter into an FFI agreement on behalf of one or more of its branches and each branch will be treated as a participating FFI and will receive a global intermediary identification number ("GIIN"). If such a branch cannot satisfy all the requirements of an FFI agreement under the laws of its jurisdiction, it will be treated as a limited branch,[69] will be subject to withholding under section IRC section 1471 and will be treated as nonparticipating FFI.[70]

The withholding may be credited against the U.S. income tax liability of the beneficial owner of the payment to which the withholding is attributable and may be refunded to the extent the withholding exceeds such liability.[71] The non-compliant FFIs failing to meet the reporting requirements may not receive a credit of refund on such tax except to the extent required by a treaty obligation of the United States.[72] Even when there is a credit or refund available to an FFI that is eligible for treaty benefits, no interest may be paid on the credit or refund.[73]

3.1 *Identifying Payee*

A participating FFI is required to report certain information on an annual basis to the IRS with respect to each U.S. investor account. The information that must be reported with respect to any U.S. investment account includes:

(i) The name, address, and taxpayer identification number ("TIN") of each account holder who is a specific U.S. person (in the case of an account holder that is a U.S. owned foreign entity, the name, address, and TIN of each specified U.S. person that is a substantial U.S. owner of each entity is required);

(ii) The account number;

(iii) The account balance or value; and

(iv) Except to the extent provided by the IRS, the gross receipts and gross withholdings or payments from the account (determined for such period and in such manner as the IRS may require).[74]

If foreign law prohibits disclosure of the personal information without the account holder's waiver and the account holder fails to provide such waiver, the FFI is required to close the account.[75]

The Treasury Department and the IRS have attempted to eliminate unnecessary burdens on compliance through an intergovernmental approach to FATCA that simplifies the registration process with the IRS. Final regulations permit FFIs in some circumstances to rely on information previously collected and to reduce the burden of identifying U.S. accounts in the following ways:

(i) The threshold is raised to USD 250,000 for preexisting accounts held by entities and for preexisting accounts that are cash value insurance and annuity contracts; in addition, final regulations exempt insurance contracts with balance or value of USD 50,000 or less from treatment as a financial account;

(ii) Due diligence and documentation rules are reduced for preexisting accounts with balances or value of USD 1,000,000 or less, letting FFIs rely solely on a search of electronically searchable account information for certain U.S. indicia – to illustrate, for accounts held by passive NFFEs, an FFI may rely on its review conducted for anti-money laundering due diligence purposes to identity any substantial US. owners of the payee in lieu of obtaining a certificate;

(iii) When the account is held by an entity, the final regulation expands the ability of FFIs to rely on a

Notes

65 I.R.C. s. 1471(d)(4) defines the term financial institution that is a foreign entity, but term does not include a financial institution organized in possession of United States except to the extent provided by the Secretary.

66 I.R.C. s. 1471(d)(1)(A) any financial account that is held by: (i) one or more "specific U.S. persons" or (ii) a "U.S. owned foreign entity." The term does not include depository accounts maintained by a natural person if the aggregate value of all depository accounts held in whole or in part by the holder and maintained by the same financial institution does not exceed USD 50,000.

67 I.R.C. s. 1472(d) foreign entity that is not a financial institution as defined in s. 1471(d)(5).

68 I.R.C. ss 1471(a), 1472(2).

69 Regulations 1.1471-4(e)(2)(iii).

70 I.R.C. s. 1471, Rev. Proc. 2014-13.

71 I.R.C. s. 1471(b); see also T.D. 9610 (Jan. 17, 2013).

72 I.R.C. s. 1474(b)(2)(A)(ii); see also T.D. 9610 (Jan. 17, 2013).

73 I.R.C. s. 1274(B)(2)(A)(i)(II).

74 I.R.C. ss 1471-1474, see also T.D. 9610 (Jan. 17, 2013).

75 I.R.C. s. 1471(b)(1)(F); see also T.D. 9610 (Jan. 17, 2013).

self-certification from an account holder as to its Chapter 4 status;

(iv) More reasonable time frames are allowed to minimize the burden and cost of reviewing existing accounts and for otherwise implementing FATCA obligations.[76]

The final regulations make several changes to the withholding process. Among other things, the final regulations:

(i) Clarify the exception to withholding when a withholding agent lacks control, custody, or knowledge of payment;[77]

(ii) Treat a payment as subject to withholding in the absence of knowledge of its source or character, or allows for an escrow of up to one-year of 30% of the payment pending a determination of the relevant facts; and

(iii) Permit an election to withhold on an account-by-account basis, provided other requirements are satisfied.[78]

Withholding is imposed only if various reporting requirements are not met. A withholding agent must determine the Chapter 4 status[79] of each payee and then decide if withholding applies. To identify a payee, a withholding agent may rely on a withholding certificate[80] (Form W-9 for U.S. persons or one of the versions of Form W-8), without obtaining additional documentary evidence.[81] A withholding agent may rely on the form unless it knows or has a reason to know that the entity classification indicated on a person's valid Form W-8 or Form W-9 is incorrect.[82]

Payments associated with Form W-9 generally will be treated as payments to U.S. persons. With foreign individuals, a withholding agent may rely on the withholding certificate, unless the agent has reason to believe the certificate is false.[83] For preexisting obligations, a withholding agent may rely on previously recorded information in the withholding agent's files. A written statement may also be relied on with respect to an offshore obligation that generates payment of U.S. source FDAP income[84] if it is accompanied by documentary evidence establishing the foreign status of the person named on the written statement. Written statements used as documentation for payments made outside of the United States on offshore obligations, other than for payments of U.S. source FDAP income, do not require signature under penalties of perjury.[85]

3.2 *Reliance on Documentation*

A withholding agent can rely on the documentation to the extent that:

(i) It held the documentation prior to the payment;

(ii) It can determine how much of the payment relates to the documentation; and

(iii) It does not know or have reason to know that any of the claims in the documentation are incorrect or unreliable.[86]

A withholding agent that is financial institution must obtain the appropriate documentation on an account-by-account basis.[87] Withholding certificates and written statements generally will remain valid until the last day of the third calendar year following the close of the year of signature.[88] The validity period is similar to the withholding certificate, but it starts from the year in which it is provided to the withholding agent.[89]

The final regulations modify documentation requirements for owner-documented FFIs by: (1) permitting transitional reliance, subject to certain requirements, on documentation collected for AML due diligence purposes for payments made prior to January 1, 2017, on preexisting obligations; (2) allowing such

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76 I.R.C. ss 1471-1474; see also T.D. 9610 (Jan. 17, 2013).

77 I.R.C. 1473(4).

78 Regulation s. 1.1471-2(a)(2)(iii); see also T.D. 9610 (Jan. 17, 2013).

79 Regulations s. 1.1471-1(b)(17), Notice 2013-69, 2013-46.

80 Regulation s. 1.1471-1(b) (139). Final regulations permits the electronic transmission of a withholding certificate that has been signed with a handwritten signature and then scanned and e-mailed to the withholding agent if the requirements of s. 1.1441-1(e)(4)(iv) are met. See TD 9610.

81 Regulation s. 1.1471-3.

82 Regulations s. 1.1471-3(b)(2).

83 Regulations s. 1.1471-3(d)(3).

84 Regulations s. 1.1441-2, for Ch. 4 purposes FDAP has same meaning as under Ch. 3.

85 I.R.C. ss 1471–1474; see also T.D. 9610 (Jan. 17, 2013).

86 Regulations s. 1.1471-3(c)(1).

87 Regulations s. 1.1471-3(c)(8).

88 Regulations s. 1.1417-3(c)(6)(ii)(A).

89 Regulations s. 1.1417-3(c)(6)(ii)(A). If documentation presented has an expiration date then they will expire on that date. *Ibid*.

entities to issue debt interests to an expanded group of holders, provided such debt holders are reported in the same manner as equity holders; (3) simplifying the withholding statement provided for an owner-documented FFI; and (4) providing for indefinite validity for withholding certificates and withholding statements submitted with respect to obligations having an aggregate value equal to or less than USD 1,000,000.[90]

The final regulations permit a withholding agent to rely upon documentary evidence obtained with respect to the payee, in lieu of a Form W-9, in order to establish the entity's status as a U.S. person and rely on the "eyeball test" under Chapter 3 and 61 to determine (to the extent applicable) the payee's status as other than a specified U.S. person under Chapter 4.[91] Also, if the withholding agent has knowledge of a change in circumstances that makes the information on the documentation incorrect, then such change will invalidate the documentation.[92]

There are certain documents that will remain valid indefinitely unless the withholding agent has knowledge of a change in circumstances that makes the information on the documentation incorrect: (1) a withholding certificate or written statement from a participating FFI or registered deemed-compliant FFI that has provided a certified GIIN; (2) a Form W-8BEN that the foreign individual provides with documentary evidence supporting individual's claim of foreign status and a lack of U.S. indicia; (3) a Form W-8BEN-E from a foreign entity if it is furnished with documentary evidence establishing the entity's foreign status; (4) a withholding certificate or an intermediary, flow-through entity, or U.S. branch; (5) a withholding certificate, written statement, or documentary evidence furnished by an exempt beneficial owner (other than a retirement fund); and (6) documentary evidence that is not generally renewed or amended (such as a certificate of incorporation).[93] In the case of certain offshore obligations, associated documentation will remain valid indefinitely.[94] Change of circumstances will result when additional information is obtained that is relevant to U.S. indicia or that conflicts with a person's Chapter 4 status.[95]

A withholding agent must retain documentation that was obtained from the payee for as long as it may be relevant to the determination of the withholding agent's tax liability.[96] A withholding agent may retain an original certified copy or a photocopy of the documentation.[97] Documentation may be submitted electronically if the withholding agent confirms that the person furnishing the form is the person named in the form and that such person signed the form under penalty of perjury.[98]

Withholding certificates (Forms W-8) must show a payee's Chapter 4 status and any other information required under sections 1471 and 1472 and the accompanying regulations. It must also provide information that is required under Chapter 3.[99] A Form W-9 or any substitute form presented by a payee must meet requirements in Regulations section 31.3406(h)-3. If a payee submits a written statement in lieu of a withholding certificate, the statement must contain all of the information relevant for determining Chapter 4 status. It must be signed under penalty of perjury.[100]

Acceptable documentary evidence supporting a claim of foreign status includes the following types of documentation:

(i) *Certificate of residence*. A certificate of residence issued by an appropriate tax official of the country in which the payee claims to be a resident that indicates that the payee has filed its most recent income tax return as a resident of that country;

(ii) *Individual government identification*. For individuals, any valid identification issued by an authorized government body that is typically used for identification purposes and contains individual's name and address;

(iii) *QI documentation*. With respect to an account maintained in a jurisdiction with anti-money laundering rules that have been approved by the IRS in connection with a QI agreement, any of the documents other than a Form W-8 or W-9 referenced in the jurisdiction's attachment to the QI agreement for identifying individuals or entities;

(iv) *Entity government documentation*. With respect to an entity, any official documentation issued by an authorized government body; and

Notes

90 I.R.C. ss 1471–1474, as amended by T.D. 9610 (Jan. 17, 2013).

91 *Ibid*.

92 Regulations s. 1. 1417-3(c)(6)(ii)(A).

93 Regulations s. 1.1471-3(c)(6)(ii)(B).

94 Regulations s. 1.1471-3(c)(6)(ii)(C).

95 Regulations s. 1.1471-3(c)(6)(ii)(E)(1).

96 Regulations s. 1.1471-3(c)(6)(iii).

97 Regulations s. 1.1471-3(c)(6)(iii).

98 Regulations s. 1.1471-3(c)(6)(iv).

99 Regulations s. 1.1471-3(c)(3)(i).

100 Regulations s. 1.1471-3(d).

(v) *Third-party credit report*. For a payment made with respect to an offshore obligation to an individual, a third-party credit report that is obtained pursuant to the conditions described in section 1.1471-4(c)(4)(ii).[101]

The withholding agent may also rely on documentation collected with respect to an entity by a third-party data provider, subject to conditions including:

(i) The third-party data provider is in the business of collecting information regarding entities and providing business reports or credit reports to unrelated customers and must have reviewed all information it has for the entity and verified that such additional information does not conflict with the Chapter 4 status claimed by the entity;

(ii) The third-party data provider collects documentation sufficient to meet the applicable documentation requirements; and

(iii) The third-party data provider provides notice of changes in circumstances. But this does not relieve the withholding agent of the obligation to determine whether that documentation is reliable based on the information contained in the documentation and other information in the withholding agent's files. Withholding agents in some instances may rely on a certification provided by a participating FFI regarding a payee's status.[102]

When a foreign intermediary or flow-through entity is not a payee, the withholding agent must obtain a valid Form W-8IMY in addition to the documentation required under Regulations section 1.1471-3(d).[103] If a chain of intermediaries or flow-through entities exist, each must submit a form W-8IMY to its withholding agent.[104] If no W-8IMY form is submitted, a written statement certifying the account holder's Chapter 4 status will suffice.[105]

Some leeway is granted to a withholding agent regarding untimely documentation and minor errors on withholding certificates (Forms W-8 or substitute forms), written statements, and documentary evidence furnished to establish the payee's Chapter 4 status.[106] A withholding agent may treat a withholding certificate as valid even if it contains an inconsequential error, if the withholding agent has sufficient documentation on file to supplement the information missing from the withholding certificate.[107]

A withholding agent may rely on the documentation to the extent it does not know or have reason to know that the documentation is incorrect.[108] Reason to know exists if:

(i) The withholding certificate is incomplete with respect to any items relevant to the claimed Chapter 4 statues;

(ii) The withholding certificate contains information inconsistent with the payee's claim;

(iii) The withholding agent has other account information that is inconsistent with the payee's claim; or

(iv) The withholding certificate does not provide sufficient information to establish Chapter 4 withholding exemption.[109]

When a withholding agent relies on an agent to review and maintain a withholding certificate, the agent's knowledge is imputed to the withholding agent.[110] A U.S. telephone number or an address in the U.S. will cause a withholding agent to have reason to know that the withholding certificate is unreliable.[111]

With documentary evidence, a different standard is applied. A withholding agent may not treat the information as valid unless it reasonably establishes the identity of the person submitting the evidence.[112] For example, if a withholding agent does not have a permanent residence address for the person, the documentation that is submitted cannot be relied on.[113] If a withholding agent only has in-care-of address or P.O.

Notes

101 Regulations s. 1.1471-3(c)(5).

102 I.R.C. ss 1471-1474; see also T.D. 9610 (Jan. 17, 2013).

103 Regulations s. 1.1471-3(c)(2)(i).

104 Regulations s. 1.1471-3(c)(2)(i).

105 Regulations s. 1.1471-3(c)(2)(ii).

106 Regulations s. 1.1471-3(c)(7).

107 Regulations s. 1.1471-3(c)(7)(i). Form W-9 errors must be resolved under I.R.C. s. 3406 and the regulations thereunder.

108 Regulations s. 1.1471-3(e).

109 Regulations s. 1.1471-3(e)(4)(ii)(A).

110 *Ibid*.

111 *Ibid*.

112 Regulations s. 1.1471-3(e)(4)(iv)(A).

113 Regulations s. 1.1471-3(e)(4)(iv)(B).

box as an address, additional documentation will be required.[114]

If a withholding agent has a U.S. address in its files, but documentary evidence indicates a foreign address, the foreign address is not reliable unless:

(i) The withholding agent has in its possession, or obtains, additional documentary evidence establishing foreign status that does not contain a U.S. address and the individual provides a written explanation supporting the claim of foreign status;

(ii) The withholding agent has in its possession, or obtains, a valid beneficial owner withholding certificate that contains a permanent residence address outside the United States and a mailing address, if any, outside the United States; or

(iii) For a payment made with respect to an offshore obligation, the withholding agent has in its possession, or obtains, a beneficial owner withholding certificate that contains a permanent residence address outside the United States.[115]

With regard to the entities, a withholding agent may presume that an entity is a foreign person regardless of U.S. indicia in any of the following circumstances:

(i) The withholding agent has in its possession, or obtains, documentary evidence establishing foreign status that substantiates that the entity is actually organized or created under the laws of a foreign country;

(ii) The withholding agent obtains a valid withholding certificate that contains a permanent residence address outside the United States and a mailing address, if any, outside the United States; or

(iii) The withholding agent is required to report payments made to the payee annually to the tax authority of the country in which the payee is located as part of that country's resident reporting requirements, and that country has a tax information exchange agreement or income tax treaty in effect with the United States.[116]

3.3 *Returns and Information Forms*

A participating FFI is required to identify and document the Chapter 4 status of each holder of an account maintained by the participating FFI to determine if the account is a U.S. account, a non-U.S. account, or an account held by a recalcitrant account holder or nonparticipating FFI and report annually certain specific payee information with respect to all U.S. accounts it maintains.[117] It also must report certain aggregate account information held by a recalcitrant account holder by filing Form 8966,[118] on magnetic media with the IRS, on or before March 31 of the following tax year, in the manner described in Regulations section 1.1471-4(d)(6). The report must be filed even if the participating FFI does not make a reportable payment to the account during the calendar year.[119]

New and revised IRS forms will be issued due to the certification, reporting and withholding requirements under Chapter 4.[120] The IRS released draft versions of the following revised forms:

(i) Form W-8IMY (Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding);

(ii) Form W-8ECI (Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States); and

(iii) Form W- 8EXP (Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding).[121]

The IRS intends to release a new Form W-8BEN-E (Certificate of Status for Beneficial Owner for United States Tax Withholding (Entities)) which can only be used by beneficial owners that are entities. The IRS has released new Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) that will be used only by beneficial owners who are individuals.

A withholding agent uses Form 1042 (Annual Withholding Tax Return for U.S. Source Income of Foreign Persons) to report Chapter 4 withholding.[122] Form 1042 is due on March 15 of the calendar year

Notes

114 *Ibid.*

115 Regulations s. 1.1471-3(e)(4)(iv)(B)(1).

116 Regulations s. 1.1471-3(e)(4)(iv)(B)(2).

117 Regulations s. 1.1471-1(c), Rev. Proc. 2014-13.

118 The new Form 8966, "FATCA Report," will be used by FFIs (including QIs, WPs, WTs) and withholding agents (in limited circumstances) to comply with their Ch. 4 reporting obligations. This new Form 8966 will set forth all the information that must be reported with respect to financial accounts in accordance with these regulations.

119 Rev. Proc. 2014-13.

120 I.R.C. ss 1471-1474, see also T.D. 9610 (Jan. 17, 2013).

121 *Ibid.*

122 Regulations s. 1.1471-1(c), Form 1042 is also used to report Ch. 3 withholding for foreign recipients.

following the year in which payments are made. An extension may be requested on Form 2758 and must be filed on or before March 15.[123]

In addition to Form 1042, which only reports the amount withheld, a withholding agent must prepare and file Form 1042-S (Foreign Person's U.S. Source Income Subject to Withholding). Form 1042-S contains more information than Form 1042, such as the type of income paid, withholding exemptions properly claimed, and amount withheld. Both forms are filed at the same time. If U.S. source royalty income and U.S. source dividend income are reported to one specific individual or entity, separate Forms 1042-S must be used.

If there is an inconsequential error on withholding certificate, the withholding agent may use documentation already on file to cure the error, but it cannot contradict the information already on the withholding certificate.[124] Regulation permits for the document to remain valid indefinitely when it falls under specified low-risk category. The Treasury Department and the IRS are considering extending this rule to Chapter 3 in appropriate circumstances.[125]

If a withholding agent over-withholds, the error may be corrected in one of two ways before Form 1042-S is issued. One way is for the withholding agent to use a set-off procedure by netting the excess withholding against any amount which otherwise would be withheld under Chapter 3 or Chapter 4 from subsequent payments to the recipient.[126] Under an alternative procedure, the withholding agent repays the withheld amount to the recipient and then reimburses itself by reducing a future deposit either in the year of the withholding or in the flowing year.[127] Repayment must be effected prior to the issuance of Form 1042-S. If neither method is followed, the recipient must claim a refund or credit by filing an income tax return.

Should under-withholding occur, the withholding agent is responsible for the underpaid tax. The withholding agent may apply the procedure under Regulations section 1.1461-2(b) to offset the underpayment by increasing withholding from a future payment or from other property. The additional withholding must be collected and paid to the Federal government during the year in which withholding occurred.[128]

A participating FFI that elects to satisfy its obligation to withhold on withholdable payments with respect to recalcitrant account holders through backup withholding under IRC section 3406, must report the amount on the applicable Form 1099. Form 1099 must be filed by the legal entity covered by this agreement and must exclude payments made by its U.S. branch, if any. A U.S. branch of a participating FFI that has not agreed to be treated as a U.S. person may make an election to apply backup withholding under IRC section 3406 with respect to withholdable payments. In that instance, it is required to file separate Forms 1099 using the EIN assigned to the branch.[129]

3.4 *Temporary Grace Period*

IRS Notice 2014-33, issued on May 2, 2014, established a major relaxation of the FATCA withholding regime that will begin on July 1, 2014. While not providing for a delayed implementation, the Notice says that all affected persons may treat 2014 and 2015 as a transition period in which such parties must show a good faith effort to comply with FATCA. As long as they act in good faith, there will be no liability for any withholding agent who did not properly withhold for FATCA or for any FFI that failed to properly register or fill out the appropriate forms. While the scope of actions that comprise good faith is somewhat unclear, this notice eliminates the need for withholding agents to seek perfection in FATCA compliance, which may have driven them to over-withhold.

3.5 *Protection of Information under FATCA*

The information received from FFIs is confidential information and can only be used to meet Chapter four requirements and for the purposes permitted under section 6103.[130] The identity of foreign financial institutions that have entered into an agreement with the IRS, however, is not treated as return information for purposes of Code

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123 Regulations s. 1.1461-1(1)(g).

124 I.R.C. ss 1471-1474, see also T.D. 9610 (Jan. 17, 2013).

125 I.R.C. s. 1474(c), see also T.D. 9610 (Jan. 17, 2013).

126 Regulations s. 1.1474-2(a)(4).

127 Regulations s. 1.1474-2(a)(3).

128 Regulations s. 1.1474-2(b).

129 Rev. Proc. 2014-13.

130 I.R.C. s. 1474(e)(1).

section 6103.[131] Violation of confidentiality under section 3406(f) will result in civil damages.[132]

4 Exchange of information under inter-governmental agreements

Many foreign countries have privacy laws that could prevent an FFI from being a participating FFI that reports financial information directly to the IRS for FATCA purposes. This can expose an FFI to the withholding requirements under FATCA because the FFI would not be a compliant participating FFI. To alleviate the problem without yielding the right to collect information, the Treasury Department has pursued a new form of agreement with foreign governments. This agreement is known as an intergovernmental agreement ("IGA") and will facilitate compliance FATCA compliance for FFIs located in countries having bank secrecy laws.

There are two alternative model IGAs that can apply to FATCA partner jurisdictions.[133] The first IGA model was published on July 26, 2012. Countries that sign this agreement agree to adopt rules to identify and report information about U.S. accounts that meet the standards set in the first IGA model. Under the first model, FFIs must identify U.S. accounts pursuant to due diligence rules adopted by the partner country. FFIs report specific information about the U.S. accounts to the partner country and the partner-county exchanges this information with the IRS in an automatic basis. In certain situations, the partner country may allow FFIs to elect to apply provisions of final regulations instead of the rules otherwise prescribed in the first IGA model.[134]

A second IGA model was published on November 14, 2012. In the second IGA model, the partner country agrees to direct and enable all FFIs that are located in the jurisdiction to register with the IRS and report specified information about U.S. accounts. Certain recalcitrant account holders, under the second model IGA, are reported by government-to-government exchange information.[135]

The Model 2 FFI is not required to deduct and withhold tax on any withholdable payment made to its non-consenting U.S. accounts, provided that the conditions under the applicable Model 2 IGA are met. If such conditions are not met, the reporting Model 2 FFI is required to treat its non-consenting U.S. accounts as held by recalcitrant account holders and is required to deduct and withhold a tax equal to 30% of any withholdable payment made to such accounts.

The IRS FATCA archive[136] indicates that the following jurisdictions have signed Model 1 IGAs AS of May 23, 2014:

Australia	France	Italy	Mexico
Belgium	Germany	Jamaica	Netherlands
Canada	Gibraltar (5-8-2014)	Jersey	Norway
Cayman Islands	Guernsey	Liechtenstein	Spain
Costa Rica	Hungary	Luxembourg	United Kingdom
Denmark	Honduras	Malta	
Estonia	Ireland	Mauritius	
Finland	Isle of Man		

The following jurisdictions have signed Mode 2 IGAs: Austria, Bermuda, Chile, Japan, and Switzerland.

The following jurisdictions have reached agreements in substance for a Model 1 IGA:

Azerbaijan	Cyprus	New Zealand	Slovak Republic
Bahamas	India	Panama	Slovenia
Brazil	Indonesia	Peru	South Africa
British Virgin Islands	Israel	Poland	South Korea
Colombia	Kosovo	Portugal	Sweden
Croatia	Kuwait	Qatar	Turks and Caicos Islands
Curaçao	Latvia	Romania	United Arab Emirates
Czech Republic	Lithuania	Singapore	

Notes

131 I.R.C. s. 1474 (c)(2); Regs. s. 1.1474-7.

132 I.R.C. ss 3406(f)(2) and 7431.

133 I.R.C. ss 1471-1474, see also T.D. 9610 (Jan. 17, 2013).

134 *Ibid.*

135 *Ibid.*

136 http://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx.

The following jurisdictions have reached agreements in substance for a Model 2 IGA: Armenia and Hong Kong.

Switzerland is one of the countries that implemented Model 2 IGA.[137]

The IGA with Switzerland was signed on February 14, 2013, and ensures that accounts held by U.S. persons with the Swiss financial institutions will be disclosed to U.S. tax authorities either with the consent of the account holder or by means of group requests within the scope of administrative assistance pursuant to Article 16 of the Convention, as amended by the protocol.[138] The Swiss IGA does not contain a commitment to work with other countries to develop a common model for automatic information exchange. The Swiss IGA agreement contains a due diligence procedure and a provision allowing Swiss Financial Institutions ("SFIs") to rely on procedures described in relevant U.S. FATCA regulations to determine whether an account is a U.S. Account or an account held by a Nonparticipating Financial Institution.[139] If an SFI relies on FATCA regulations, recalcitrant account holders will be treated as holders of a U.S. account. Once an SFI relies on the U.S. FATCA regulations, it must continue to apply the regulations consistently in subsequent years, unless the regulations have been modified.[140]

An SFI must review electronically searchable data for the following information:

(a) The account holder's citizenship or residence;

(b) The account holder's place of birth;

(c) The U.S. mailing address or residence of the account holder, including P.O. box or an "in-care-of" address in the U.S.;

(d) Instructions to transfer funds to the United States;

(e) A power of attorney or signatory authority for a person with the U. S. address; or

(f) Whether the sole address is an "in-care-of" address anywhere in the world or a "hold mail" address.

If any of the foregoing U.S. indicia is discovered, the account generally must be treated as U.S. account. There are some exceptions to this rule, for example: if there is a self-certification that the account holder is neither a U.S. citizen nor a U.S. resident for tax purposes or a government-issued passport from country other than the United States, the account may not be treated as a U.S. account.[141]

The Swiss IGA provides that U.S. Competent Authority may make group requests to the Swiss Competent Authority, based on the aggregate information reported to the IRS for all the information about non-consenting U.S. accounts and foreign reportable amounts paid to non-consenting nonparticipating financial institutions that the reporting Swiss financial institution would have had to report under an FFI Agreement had it obtained the consent.[142]

These requests will be made pursuant to Article 26 of the income tax treaty between the U.S. and Switzerland, as amended by the 2009 protocol, whenever it becomes effective. The requests will apply to information for the time period beginning on or after the entry into force of the protocol.[143] Any information received will be treated as secret in the same manner as information obtained under the domestic law of that State and will be disclosed only to persons or authorities, including courts and administrative bodies, involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the treaty. No information will be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.[144] Even though the proposed protocol[145] prohibits using the information received for purposes other than those related to the administrative, assessment, or collection of taxes covered by the treaty, information may be used for other purposes, so long as laws of both countries permit such use. However, the technical explanation prepared by the U.S. Treasury Department explains that extended use is only allowed under the provisions of the U.S.-Swiss Mutual Legal Assistance Treaty that was entered into force in 1977.[146]

On November 29, 2013, the Cayman Island signed a non-reciprocal Model 1B IGA. Under the agreement

Notes

137 Agreement between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA, Feb. 14, 2013.

138 The IGA between Switzerland and the United States appears at: http://www.admin.ch/aktuell/00089/index.html?lang=en&msg-id=47779.

139 Agreement between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA, Annex 1(I)(C) Feb. 14, 2013.

140 *Ibid*.

141 Agreement between the United States of America and Switzerland for Cooperation to Facilitate the Implementation of FATCA, Annex 1(II)(B) Feb. 14, 2013 [hereinafter IGA with Switzerland].

142 IGA with Switzerland, Art. 5(1) Feb. 14, 2013.

143 *Ibid*.

144 Convention Between the United States of America and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income, signed at Washington, Oct. 2, 1996, Together with a Protocol to the Convention. Effective dates Jan. 1, 1998.

145 Protocol Amending Tax Convention with Switzerland, May 23, 2009.

146 2014 TNT 39-28.

Cayman Island Financial Institutions ("Cayman FIs") will report directly to the Cayman Tax Information Authority ("Cayman TIA") on U.S. reportable accounts on annual basis. The Cayman TIA will forward this information to the U.S. Internal Revenue Service on annual basis pursuant to the provision of Article 6 of the Cayman TIEA. Cayman FIs that comply with the IGA will be treated as "deemed compliant" and will not be subject to withholding.[147] The agreement further breaks down FIs into the "reporting FIs"[148] and "non-reporting FIs."[149] All FIs are reporting FIs, unless they meet the requirement under Annex II for exempt beneficial owners or deemed-compliant FFIs. Among other things, reporting FIs are required to obtain information on U.S. account holders, including:

(a) The name, address, and U.S. TIN of each Specified U.S. Person that is an account holder of an account;

(b) The account number;

(c) The name and identifying number of the Reporting Cayman FI; and

(d) The account balance or value as of the end of the relevant calendar year or other appropriate reporting period.[150]

Non-participating FIs do not have to register with the IRS and comply with FATCA regulations but they will have to provide certification to withholding agents to show that they are deemed-compliant FIs.[151]

All information exchanged is subject to the confidentiality and other protections provided for in the TIEA, including the provisions limiting the use of the information.[152] The information received is treated as confidential and may be disclosed only to persons or authorities, including courts and administrative bodies, in the jurisdiction of the jurisdiction concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the TIEA, or the oversight of any of the foregoing functions.

The information may be disclosed in public court proceedings or in judicial decisions. The information may not be disclosed to any other person, entity, authority or jurisdiction. If the requested party provides prior written consent, the information may be used for purposes permitted under the provisions of the income tax treaty between the U.S. and the U.K. concerning the Cayman Islands Relating to Mutual Legal Assistance in Criminal Matters or any successor treaty.[153]

5 Anti-avoidance groups

The U.S. participates in several global organizations that have prevention of tax avoidance as a principal goal. In each instance, effective exchange of information is a major tool to combat avoidance.

5.1 *JITSIC (Joint International Tax Shelter Information Center)*

JITSIC was established in April 2004 by the Commissioners of the Australian, Canadian, the U.K., and the U.S. tax administrations. A representative from each of these administrations began working together at the Washington, D.C. office of JITSIC in September 2004. The success of that office led to opening of an office in London in September 2007. JITSIC's mandate is to broaden the scope for information exchange and knowledge-sharing to combat cross-border tax avoidance. Today the JITSIC consists of the tax administrations from nine member countries: Australia, Canada, Japan, the U.K., the U.S., South Korea, China, France, and Germany.[154]

JITSIC represents a successful operation to exchange information on a real-time basis. This includes:

(i) Providing support to members through the identification and understanding of abusive tax schemes and those who promote them;

(ii) Sharing expertise, best practices and experience in tax administration to combat abusive tax schemes;

(iii) Exchanging information on abusive tax schemes, in general, and on specific schemes, their promoters, and investors consistent with the provisions of bilateral tax conventions;

Notes

[147] Agreement between the Government of the Cayman Islands and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA, Art. 4 Nov. 29, 2013.

[148] *Ibid*.

[149] IGA with Cayman Islands, Art. 4 Nov. 29, 2013. Annex II (ex: retirement and pension plans, term life insurance contracts, and etc.).

[150] IGA with Cayman Islands, Art. 2 Nov. 29, 2013.

[151] IGA with Cayman Islands Annex II, Nov. 29, 2013.

[152] IGA with Cayman Islands Art. 3, (7), Nov. 29, 2013.

[153] Agreement between the Government of the United States of America and the Government of the Cayman Islands for the Exchange of Information Relating to Taxes, art. 10, Nov. 29, 2013.

[154] Speech by Commissioner of Taxation Michael D'Ascenzo to the Australia Israel Chamber of Commerce: "It's a small world after all – Australia's place in a Global Environment," Melbourne, Jul. 5, 2012.

(iv) Enabling members to better address abusive tax schemes promoted by firms and individuals who operate without regard to national borders;[155]

(v) Developing new internet search and other techniques for early identification of promoters and investors involved in abusive tax schemes;

(vi) Identifying emerging trends and patterns to anticipate new, abusive tax schemes; and

(vii) Improving the members' knowledge of techniques used to promote abusive tax schemes cross-border.[156]

In its literature, JITSIC claims the following successes in combating highly artificial arrangements:

(i) It identified and stopped a cross-border scheme involving hundreds of taxpayers and tens of millions of dollars in improper deductions and unreported income from retirement account withdrawals;

(ii) It identified and stopped highly structured financing transactions, created by financial institutions, in which taxpayers generated inappropriate foreign tax credit benefits;

(iii) It identified and stopped brokers who provided made-to-order losses on futures and options transactions for individuals in other JITSIC jurisdictions, leading to a tax loss of more than USD 100 million;[157]

(iv) It identified debit and stopped the use of credit cards linked to offshore accounts used to repatriate funds from tax havens.[158]

The Commissioners of the JITSIC Member States have announced plans to expand throughout North America, Europe, and Asia. They plan to broaden the focus of their investigations, share best practices on risk assessment and other key areas of interest, and increase the transparency of cross-border transactions in order to create a level playing field for taxpayers who are voluntarily compliant.[159]

In 2009, member countries agreed to the Terms of Reference to identify initial areas of focus.[160] These are:

(i) Tax administration issues arising from the global economic environment and financial crisis;

(ii) Use of off-shore arrangements to avoid tax;

(iii) Arrangements used by high wealth/income taxpayers to minimize their tax liabilities; and

(iv) Tax administration approaches and activities to improve transfer pricing compliance.[161]

5.2 *OECD: Forum on Tax Administration (FTA)*

The FTA is a forum for cooperation between revenue bodies at the commissioner-level. It has forty-five participating countries. The goal of the FTA is the improvement of taxpayer services and tax compliance by helping tax administrations increase efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance.

"*Tax Administration 2013*" published in May, is a comprehensive source of comparative information about tax administration available. The report encompasses 379 pages. With regard to large taxpayer groupings, the report identifies several common characteristics, including the concentration of revenue within a small number of large taxpayers, the complexity of business and tax dealings that result in significant compliance risks, the reliance on professional advisors to provide planning, and the need for cooperative compliance strategies between taxpayers and tax authorities. With regard to high net worth individuals, the report emphasizes the need for greater international cooperation at both a stregic and operational level. The goal is to improve the sharing of information and expertise between revenue bodies.

At the conclusion of the FTA meeting in Moscow in May 2013, the final communique addressed offshore tax evasion in the following terms:

> Offshore evasion
>
> As tax administrators, where we detect offshore evasion we share the information with our partners. We have developed tools to improve the gathering of information on cross-border financial transfers, to decode banking transactions and to identify the beneficial owners of complex structures. Three of our members (Australia, United Kingdom, United States) have obtained a very significant amount of data, revealing complex offshore structures and will now use this data to share information relevant to other

Notes

[155] Joint International Tax Shelter Information Center Memorandum of understanding, 2004, for a copy of its memorandum of understanding, which appears at http://www.irs.gov/pub/irs-utl/jitsic-finalmou.pdf.

[156] *Ibid*.

[157] Internal Revenue Service, News Release IR-2007-104 (May 23, 2007).

[158] *Ibid*.

[159] *Ibid*.

[160] For a copy of its Terms of Reference, see http://www.irs.gov/pub/irs-utl/jitsictermsofref.pdf.

[161] *Ibid*.

members. Given the magnitude and complexity of the data we will work together to analyse it.

We strongly encourage closer inter-agency co-operation in the fight against tax crimes and in that regard, we have identified particular synergies, in combating tax and customs evasion and avoidance, that we will fully exploit.

We noted that several of our members have called on the International Consortium of Investigative Journalists to share the data they have acquired about offshore evasion. We would encourage any party that holds such information to share it with the relevant tax authorities, redacted if necessary to protect their sources.

The message to tax evaders and those who facilitate tax evasion is simple: however hard you try to hide, we will find you.

Increasing transparency and exchange of information

We want increased transparency and comprehensive exchange of information. We will rapidly increase the use of the provisions of the greatly expanded network of agreements allowing for exchange of information, including by providing necessary training to tax auditors, and we will ensure effective and secure use of information received under those agreements. In addition, we welcome the growing focus on automatic exchange of information and strongly endorse the G20 call urging all jurisdictions to move towards exchanging information automatically, which is expected to be the standard; and to do so with their treaty partners as appropriate.

5.3 *Inter-American Center of Tax Administrations (CIAT)*

CIAT is a non-profit international public organization that provides specialized technical assistance for the modernization and strengthening of tax administrations. It was founded in 1967 and has thirty-nine members and associate members, encompassing countries from the Americas, Europe, Africa, and Asia. The U.S., Spain, France, the Netherlands, and Canada are members.

A principal goal of CIAT is the promotion of mutual assistance and cooperation among member countries by:

(i) Developing specialized technical assistance programs based on the particular needs and interests of member countries, through technical cooperation activities; and

(ii) Encouraging studies and research projects about tax systems and administrations, promoting timely dissemination of relevant information and the exchange of ideas and experiences through general assemblies, technical conferences, seminars, publications and other appropriate means.

In September 2013, CIAT sponsored a conference in Nairobi, Kenya addressing the prevention and control of tax evasion. In the conference, the Spanish State Agency of Tax Administration delivered a paper entitled "Tax Audit In The Digital Age." While the paper discusses digital audit techniques to identify tax evasion, it emphasizes techniques that promote an effective exchange of information arising from a mutual assistance request between tax authorities, based on its recent experience:

International mutual assistance in the digital age

The internationalization of the Spanish economy has led to the intense development of fiscal relations with other countries. The number of requests for information received from other jurisdictions has considerably grown in recent years. The claims management system was based on communications on paper which generated a physical to be sent to the territorial services of the domicile of the taxpayer to be controlled. This territorial service made appropriate inquiries, made a report and returned it to the competent authority for information exchange. This control system by the competent authority was based on a file and a registry book based in a file number with successive dates and differentiation of countries.

When the responses arrived, a copy of the file was made and was filed; the original response was sent by mail, fax or courier services. The communication costs were extraordinary and very often there were errors in the shipping address so that information did not arrive or arrived out of deadline. Leaks were not frequent but they involved the risk of violating the disclosure and secret principle to which we are obliged.

The solution has been found through two channels. First the use within the European Union of a secure email network maintained by the Commission. Currently more than 98% of the questions and answers are made using the secure mail. To be able to send scanned copy of reports and documentation, there were resistances to overcome and a large capacity scanner was required. The price of the scanner was below the costs of two weeks of messaging services.

The second part consisted in the design of an application, called Inter, for managing this type of files, that uses the intranet and assumes that the paper does not travel and everything is recorded. This involved a great capacity to seek records by various criteria such as the registration number, tax identification number subject to the demand for information and the person of the other country, name, country, dates, etc. On the other hand it allows integrating this information in the general database from each taxpayer. It also facilitated the response in cases of several questions on the subject. The system has a record of dates which allows reminders when deadlines are close, and the file is still open. And of course allows writing, with easily obtainable data, reports and statistics on compliance deadlines.

5.4 *International Tax Dialogue (ITD)*

The ITD is a collaborative arrangement involving the European Commission, the Inter-American Development Bank, the International Monetary Fund, the OECD, the World Bank group and CIAT. Its stated goal is to encourage and facilitate discussion of matters among national tax officials, international organizations and other key stakeholders. Its administration is currently hosted by the OECD.

The ITD focuses on international and domestic tax policy and administration issues. It promotes effective international dialogue and networking between international organizations, governments and their officials on tax policy and administration matters. It identifies and shares good practices in taxation with a focus on technical assistance on tax matters. In that regard, the ITD promotes a USAID publication, *Detailed Guidelines for Improved Tax Administration in Latin America and the Caribbean* (2013), which provides a comprehensive view of tax administration functions and operations, including actionable guidance to help tax administrators and donors understand leading practices, pinpoint areas with potential for improvement, and take steps towards more effective and efficient tax administration.

Later this year, it will host a workshop for members on exchanges of information. According to its website:

> Exchange of information between tax administrations is the most effective way of combating international tax avoidance and evasion. The aim of this workshop is to share the experiences of OECD and non-OECD economies as regards the exchange of tax information between competent authorities; and to identify ways of improving the efficiency of this process. The workshop will draw upon OECD work in this area. The underlying legal basis for international exchange of information will be examined (Article 26 of the OECD Model Tax Convention, Model TIEA, revised Multilateral Convention on Mutual Administrative Assistance in Tax Matters, other relevant regional instruments on Mutual Assistance). Cases studies will illustrate the key concepts of exchange of information highlighting the balance between the legal obligation to exchange and the limitations that protect taxpayers? rights in exchange of information. Besides exchange on request other forms of exchange (spontaneous, automatic, simultaneous tax examinations) will also be presented. Practical advice will be provided on how to organise a Competent Authority Unit, on how to raise the awareness of tax examiners about the potential of exchange of information, and how to make a request for information and to respond to a request.

ITD will also host two conferences on taking advantage of the Multilateral Assistance Conveniention. According to the ITD website:

> The amended Convention facilitates international co-operation for a better operation of national tax laws, while respecting the fundamental rights of taxpayers. The amended Convention provides for all possible forms of administrative co-operation between the Parties in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. This co-operation ranges from exchange of information, including automatic exchanges, to the assistance in the recovery of foreign tax claims
>
> The Convention also provides for the possibility of sharing of information obtained for tax purposes by tax authorities with law enforcement and judicial authorities if certain conditions are met. It will allow fighting tax crimes and other financial crimes more effectively by allowing tax and law enforcement agencies to cooperate more closely as recommended in the OECD "Oslo Dialogue" to promote a whole of government approach to tackling financial crimes and illicit flows.
>
> This event will discuss the multiple ways to take advantage of this powerful instrument in the areas of exchange of information, assistance in tax collection, exchange of tax intelligence, bilateral/multilateral simultaneous tax examinations and joint audits covering both direct and indirect taxes etc. It will also discuss under what conditions the information

5.5 *Other Groups*

Other intergovernmental groups to which the U.S. belongs and which promotes exchanges of information in order to prevent global tax evasion are e Leeds Castle Group (LCG), which superseded the Pacific Association of Tax Administrators (PATA) in 2006 and the Seven Country Working Group on Tax Havens (SCWG).

LCG members include Australia, Canada, China, France, Germany, India, Japan, Korea, the U.K., and the U.S. Participation is restricted to the revenue commissioner plus one attendee. The group considers issues of national and global interest to revenue commissioners, particularly compliance challenges best practices.

The SCWG consists of Australia, Canada, France, Germany, Japan, the U.K., and the U.S. The group's work is focused on sharing information about the use of tax haven jurisdictions in connection with abusive cross-border transactions. Common areas of concern include e-commerce, offshore credit or debit cards, re-invoicing, intangibles and offshore banking and brokerage.

6 Final regulations require banks to report interest on nonresidents alien bank deposits

The U.S. has entered into income treaties with at least seventy countries that provide for exchanges of information upon request.[162] In addition, the U.S. has entered into agreement calling for the automatic exchange of information with several non-treaty counties.[163] The United States' government believes that reciprocity is the key to success in such agreements and will provide information to those countries as an incentive to provide information to the U.S.[164] As a result, final regulations have been published requiring banks have to report interest paid to the nonresident alien individuals who are residents of foreign countries that have TIEAs in effect with the United States.[165] This rule was challenged at the United States Court for the District of Columbia[166] by the Florida Bankers Association and the Texas Bankers Association. They argued that regulation violated the Administrative Procedure Act and the Regulatory Flexibility Act. However, the court upheld the validity of the regulations, finding that the IRS reasonably concluded that the regulations will improve U.S. tax compliance, deter foreign and domestic tax evasion, impose a minimal reporting burden on banks and not cause any rational actor, other than a tax evaders, to withdraw funds from U.S. accounts.[167]

The IRS conceded that this regulation will have an affect on many small banks, but it would not be a "significant economic impact" because banks have already developed system to report similar information for U.S. and Canadian taxpayers,[168] U.S. banks can use W-8 information, which contains data on residency and citizenship for all accountholders, to produce Form 1042-S.[169] The IRS believes that the regulations would have a significant economic impact on U.S. financial institutions because they already have the responsibility to withhold on and report with respect to depositors who are U.S. citizens, U.S. resident individuals, and Canadian resident individuals, and have developed the systems to perform such withholding and reporting. The Bankers Association also requested an explanation from the IRS why routine reporting was required instead of issuing summons for information on case-by-case basis. The IRS believes it is easier to receive information routinely than to issue a series of summonses whenever a treaty partner requests information. The IRS noted that its objective was to ensure exchange of tax information reciprocally with a treaty partner when it is appropriate to do so. The objective is to have the information on hand when a treaty partner requests it – not to have access to it only at some later date after a summons is issued and responded to.[170]

Finally, addressing the argument of capital flight, the IRS responded that there are privacy protections in place to safeguard account information, including the fact that "all of the information exchange agreements to which the United States is a party require that the information exchanged under the agreement be treated and protected as secret by the foreign government" as well as by the IRS. If banks' customers are tax evaders, they would clearly have an incentive to withdraw their funds as a result of the new regulations. Leaving the undisclosed funds in American banks might have unfortunate consequences in their homelands for those accountholders. The IRS believes there is no evidence on the record that shows that the Canadian reporting regulations caused the so-called capital flight that began two years after the regulations took effect.

The information will be exchanged only with foreign governments with which the United States has an agreement providing for the exchange of information, and only when certain additional requirements are satisfied. The IRS is not compelled to exchange information, regardless of the agreement with the foreign government, if there is concern regarding the use of the information or other factors exist that would make exchange inappropriate.[171]

Strict confidentiality rules apply to exchange of return information under IRC 6103. Moreover, there is a limitation to the exchange power of the IRS. It can only provide information to the extent, and subject to the terms and conditions of, an information exchange agreement.[172] Absent of exchange of information agreement, the IRS is statutorily barred from sharing return information with another country.[173]

Consistent with established international standards, the United States will not enter into an information exchange

Notes

162 Rev. Proc. 2012-24.

163 *Ibid*.

164 *Florida Bankers association v. United States Department of Treasury*, Civil Action No. 13-529 (JEB) (2014).

165 Regulations s. 1.6049-(b)(5) and -8, as adopted by T.D. 9584 (May 14, 2012).

166 Civil Action No. 13-529 (JEB).

167 *Florida Bankers association v. United States Department of Treasury*, Civil Action No. 13-529 (JEB) (2014).

168 *Ibid*.

169 *Ibid*.

170 *Ibid*.

171 T.D. 9584, May 14, 2012.

172 I.R.C. s. 6103(K)(4).

173 T.D. 9584 May 14, 2012.

agreement unless the Treasury Department and the IRS are satisfied that the foreign government has strict confidentiality protections.[174] Specifically, prior to entering into an information exchange agreement with another jurisdiction, the Treasury Department and the IRS closely review the foreign jurisdiction's legal framework for maintaining the confidentiality of taxpayer information.[175] In order to conclude an information exchange agreement with another country, the Treasury Department and the IRS must be satisfied that the foreign jurisdiction has the necessary legal safeguards in place to protect exchanged information and that adequate penalties apply to any breach of that confidentiality.[176]

Finally, even if an information exchange agreement is in effect and the IRS determines that the country is not complying with its obligations under the agreement to protect the confidentiality of information, the IRS will not exchange any return information.[177]

Notes

174 *Ibid*.

175 *Ibid*.

176 *Ibid*.

177 *Ibid*.