

Reporting Foreign Financial Assets Under Titles 26 and 31: FATCA and FBAR

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Summary

All citizens of the United States as well as U.S. resident aliens are required to report their world-wide income for U.S. federal income tax purposes. However, where foreign assets are involved, this is an area in which taxpayers, knowingly or unknowingly, may fail to comply with the law. There are numerous information reporting requirements involving foreign assets that may assist the Internal Revenue Service (IRS) in recognizing a failure to report foreign income; however, both taxpayers and tax preparers may not be fully compliant with filing these forms. Again, this may be more a matter of ignorance of the requirements than any intent to skirt the law.

Neither the reporting requirement imposed by the Foreign Account Tax Compliance Act (FATCA) nor the Foreign Bank Account Reporting (FBAR) imposed by the older Bank Secrecy Act directly involves reporting income for tax purposes. Instead, each involves reporting the existence of financial assets or accounts located outside of the United States. Although in some cases the same accounts or assets may be reported on each information-reporting form, both forms may be required. Failure to file either form if required may result in significant penalties, in some cases amounting to the entire balance of the unreported account or more.

Tax evasion through offshore accounts can be facilitated by foreign financial institutions (FFIs) or other financial intermediaries. Although they may not be complicit in the tax evasion, these entities can play a part in curbing offshore tax evasion by reporting information on assets owned or controlled by entities subject to U.S. income tax. FATCA imposes reporting requirements on FFIs regarding their U.S. account holders, as well as obligations on non-financial foreign entities (NFFEs) regarding their U.S. owners. If the requirements are not met, then any withholdable payment to the entity is subject to withholding of tax at a rate of 30%.

Since FATCA's passage, there has been criticism of the FFI and NFFE provisions and how they relate to other countries, including whether FATCA's requirements are inconsistent with existing U.S. treaty obligations and what happens when the requirements conflict with another country's domestic (e.g., banking or privacy) laws. The Treasury Department and IRS have reached out to other countries and entered into bilateral intergovernmental agreements with 24 of them. In general, these provide that the other country's FFIs will be deemed compliant with FATCA's requirements if they comply with the agreement. FATCA's requirements have also been criticized as overly burdensome and stakeholders have indicated they have insufficient time to prepare for them. The IRS has responded by extending various deadlines under FATCA—while the 2010 law enacting FATCA provides that, in general, its provisions “apply to payments made after December 31, 2012,” the IRS has on several occasions extended various deadlines, with many provisions scheduled to go into effect on July 1, 2014.

Finally, legislation has been introduced in the 113th Congress that would repeal much of FATCA (S. 887); modify FATCA with the intent of “strengthening” it (H.R. 1554, H.R. 3666, S. 1533, and S. 268); or require that its effects on U.S. citizens living abroad be studied (H.R. 597).

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The term “gross income,” according to the Internal Revenue Code (IRC), generally “means all income from whatever source derived.”¹ As a result, worldwide income is subject to taxation by the United States. Thus, U.S. citizens² and U.S. residents generally are required to pay U.S. income tax on income from sources in foreign countries. Nonetheless, it has been reported that some taxpayers apparently believe that they can successfully avoid U.S. income tax by maintaining assets outside of the country. This “avoidance” is actually “evasion,” which is illegal. Until recently, it was very difficult for the Internal Revenue Service (IRS) to detect such evasion. Changes in laws, penalties, and enforcement activity are making it easier to encourage compliance with U.S. tax laws.

For many years, U.S. taxpayers have been required to report various foreign accounts to the Department of the Treasury under the Bank Secrecy Act of 1970.³ Over time, additional provisions have been added to that act to encourage such reporting. More recently, Congress enacted a separate provision in the Foreign Account Tax Compliance Act (FATCA) that has reporting requirements that in some cases may result in the same account being reported on two different forms, but which includes reporting requirements for assets not covered by the earlier act. Additionally, FATCA includes requirements for information reporting by foreign financial institutions (FFIs) and other financial intermediaries. In some cases, withholding tax requirements may be imposed on these entities.

This report outlines the U.S. reporting requirements for foreign assets and accounts under FATCA along with the reporting requirements (FBAR) under the Bank Secrecy Act. It also addresses the requirements imposed on foreign financial institutions and the agreements the United States has with other countries to cooperate in information reporting. Additionally, recently proposed bills to modify FATCA either through repeal or amendment are discussed.

Reporting by U.S. Tax Entities

In addition to being required, generally, to report all income from accounts and assets even if located outside the United States, certain persons are required to report the existence of such foreign assets either via Form 8938, which is filed along with their tax returns, or by electronically filing FinCEN Form 114 (FBAR) with the Department of the Treasury. In some cases, they must file both even if doing so appears to be duplicative.

Title 26

The Foreign Account Tax Compliance Act,⁴ enacted in 2010 as part of the Hiring Incentives to Restore Employment Act, requires “specified persons” to report “specified foreign financial assets” located outside the United States.⁵ However, this reporting is subject to filing thresholds. “Specified persons” includes both entities and individuals; however, although “specified

¹ 26 U.S.C. § 61(a).

² U.S. citizens must report worldwide income no matter where they reside. However, in some circumstances, income earned abroad may be excluded from taxation.

³ P.L. 94-508.

⁴ P.L. 111-147, Title V, Subtitle A, 124 Stat. 97 (Mar. 18, 2010).

⁵ 26 U.S.C. § 6038D.

individuals” and their related requirements for filing Form 8963 have been defined in regulation, there is currently no such legal definition of specified entities.⁶ As a result, the following outline of requirements applies only to individuals.

Requirements

Specified Persons

Specified individuals (SIs) include U.S. citizens, U.S. resident aliens (even if resident for only part of the year), nonresident aliens who elect to be treated as resident aliens for purposes of filing a joint tax return, and nonresident aliens who are bona fide residents of Puerto Rico, Guam, American Samoa, the Northern Mariana Islands, or the U.S. Virgin Islands.⁷

Specified Foreign Financial Assets

Specified foreign financial assets (SFFAs) include financial accounts maintained at foreign financial institutions (e.g., savings or checking accounts, brokerage accounts, or retirement accounts held with a bank or broker-dealer). They also include assets held for investment, but not held in a financial account. Examples include any interest in a foreign entity, including stock or securities issued by a foreign corporation and any financial instrument or contract with a foreign issuer or counterparty. However, shares of stock issued by a foreign corporation are not considered SFFAs if they are held inside a U.S. brokerage or financial account. Additionally, some assets are not reportable if held directly by the specified individual. These include foreign real estate, foreign currency, and foreign Social Security-type programs.⁸

Filing Thresholds

The filing thresholds are based on the total value of all SFFAs. SIs who file joint returns and live in the United States are not required to file Form 8938 if the total value of their SFFAs is \$100,000 or less on the last day of the tax year and \$150,000 or less at all times during the tax year. If the couple is living abroad, the thresholds are higher: \$400,000 on the last day and \$600,000 at all times. For all other SIs, the thresholds are \$50,000 and \$75,000 if living in the United States and \$200,000 and \$300,000 if living abroad—in other words, half that of a married couple that files jointly.⁹

U.S. citizens are considered to have been living abroad if they are bona fide residents of a foreign country for an uninterrupted period that includes the entire year or were present in a foreign country at least 330 days during any 12-month consecutive period that ends in the tax year.

⁶ See Prop. Reg. § 1.6038D-6.

⁷ Temp. Reg. § 1.3028D-1T(a)(2).

⁸ Internal Revenue Service, “Do I Need to File Form 8938, ‘Statement of Specified Foreign Financial Assets?’” <http://www.irs.gov/Businesses/Corporations/Do-I-need-to-file-Form-8938,-%E2%80%9CStatement-of-Specified-Foreign-Financial-Assets%E2%80%9D%3F>.

⁹ *Id.*

Penalties

Penalties for failure to file a required Form 8938 begin at \$10,000 and may be as much as \$50,000 if the form is not filed in a timely manner after the individual has been informed by the IRS that the individual has failed to comply with the requirement to report SFFAs. In addition to the penalty for failure to file Form 8938, taxpayers who fail to report income from such assets on their tax returns are subject to a penalty of 40% of the tax due on that income (in addition to the tax on the income).¹⁰ There is no differentiation in the penalty based on willfulness of the failure to file.

Title 31

Since 1970, Title 31 of the U.S. Code¹¹ has required “U.S. persons”¹² to report foreign financial accounts they own or for which they have signatory authority. This requirement is separate from the requirement to report income from accounts owned by U.S. persons on the relevant income tax returns.

“Financial accounts” is a broad term that can include bank accounts, security accounts, some life insurance, mutual funds, and such accounts held by an entity in which one has a significant interest. Many foreign financial accounts are also considered foreign financial assets for purposes of reporting under Title 26, but the latter term generally is more inclusive. Furthermore, the distinctions are not intuitive. The IRS provides a chart of various types of assets along with whether they are reportable under either Title 31 or Title 26.¹³

Requirements

Generally, foreign financial accounts must be reported under Title 31 if the aggregate value of all such accounts is over \$10,000 at any time during the year. The report is made on FinCen Form 114, Report of Foreign Bank and Financial Accounts [FBAR]. This form replaces another used for many years—TD F 90-22.1—and must be filed electronically. Forms not received by the Department of the Treasury by June 30 are considered delinquent—no extensions are available.¹⁴

Penalties

Penalties for failure to file an FBAR can be quite severe. In addition to a rarely imposed negligence penalty, there are penalties imposed for either willful or non-willful failure to file the required FBAR, with the penalty for willful failure to file being the most severe and including the possibility of criminal as well as civil penalties.

¹⁰ 26 U.S.C. § 6662(j)(3).

¹¹ 31 U.S.C. § 5311 *et seq.*

¹² The term “U.S. person” includes individuals who are either U.S. citizens or residents, as well as corporations, partnerships, trusts, limited liability companies, and Indian tribes. 31 C.F.R. § 1010.350(b).

¹³ Internal Revenue Service, “Comparison of Form 8938 and FBAR Requirements,” <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements>.

¹⁴ Some individuals—generally financial professionals—having signature authority over foreign financial accounts, but no interest in the accounts, have been granted a special filing extension for some prior year filings. See FinCEN Notices 2011-1, 2011-2, and 2012-2; as well as IRS Notices 2009-62, 2010-23, and 2011-54.

Willful Failure to File

If failure to file an FBAR is found to be willful, there may be both criminal and civil penalties. Criminal penalties can include both a fine (up to \$250,000) and up to five years in prison.¹⁵ The maximum civil penalty on each account is the *greater* of \$100,000 or 50% of the balance of the account.¹⁶

In determining whether failure to file a required FBAR was willful, courts have thus far found that the government must prove its case by a preponderance of the evidence¹⁷ rather than by the more demanding standard of clear and convincing evidence.

Non-Willful Failure to File

If the failure to file the FBAR was not willful, the maximum penalty is \$10,000 per account. This penalty may in some cases be waived if the failure was due to a reasonable cause *and* the account was later properly reported on an FBAR.¹⁸

Reporting by Foreign Entities

Tax evasion through offshore accounts can be facilitated by foreign financial institutions (FFIs) or other financial intermediaries. Although they may not be complicit in the tax evasion, these entities can play a part in curbing offshore tax evasion by reporting information on assets owned or controlled by entities subject to U.S. income tax. FATCA imposes reporting requirements on FFIs regarding their U.S. account holders, as well as obligations on non-financial foreign entities (NFFEs). These provisions address gaps in the pre-existing legal authorities that the IRS uses to learn information about taxpayers suspected of evading U.S. taxes. Some of the primary authorities are summarized in **Table 1**.

Table 1. Selected Legal Authorities Available to the IRS

Name	Summary of Authority
Qualified Intermediary (QI) program	Established by the IRS in 2000/2001 “to simplify withholding and reporting obligations for payments of income ... made to an account holder through one or more foreign intermediaries.” Foreign banks and other qualifying entities voluntarily enter into agreements with the IRS to collect documentation about their customers; report on and withhold U.S. source income paid to certain customers; and submit to audits. In exchange, they are subject to loosened reporting and withholding requirements, which include not having to disclose certain customers. Rev. Proc. 2000–12, 2000-1 C.B. 387; see also IRS, <i>Miscellaneous Qualified Intermediary Information</i> , at http://www.irs.gov/Businesses/International-Businesses/Miscellaneous-Qualified-Intermediary-Information .

¹⁵ 31 U.S.C. § 5322(a).

¹⁶ 31 U.S.C. § 5321(a)(5)(C).

¹⁷ *McBride v. United States*, 908 F. Supp. 2d 1186 (D. UT 2012); *United States v. Williams*, No. 1:09-cv-437, 2010 WL 3473311 (E.D. Va. Sep. 1, 2010), rev’d on other grounds, *United States v. Williams*, No. 10-2230, 2012 WL 2948567 (4th Cir. Jul. 20, 2012).

¹⁸ 31 U.S.C. § 5321(a)(5)(B)(ii).

Name	Summary of Authority
Bilateral Income Tax Treaties and Tax Information Exchange Agreements (TIEAs) (the former are used to limit incidences of double taxation and tax avoidance, while the latter are generally for countries without a tax treaty)	<p>Provide for the exchange of tax-related information by specific request of one country or, in some cases, automatically—generally for both civil and criminal tax purposes. For example, Article 26, Exchange of Information and Administrative Assistance, of the U.S. Model Treaty provides that the countries will exchange information as may be relevant for carrying out the treaty or either country’s domestic tax laws. It does not require a country to carry out administrative measures at variance with its laws and administrative practice, or to supply information not available under its laws or in the normal course of administration or information that would violate trade secrets or public policy.</p> <p>For a model TIEA, see OECD, <i>Agreement on Exchange of Information on Tax Matters</i>, http://www.oecd.org/ctp/exchange-of-tax-information/2082215.pdf. See also U.S. Dep’t of the Treasury, <i>Tax Treaties and TIEAs</i>, http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/treaties.aspx.</p>
Mutual Legal Assistance Treaties (MLATs)	<p>Generally provides for the exchange of evidence and information in criminal matters—they are not restricted to tax matters. Some contain restrictions that will limit the other country’s assistance for tax-related matters. See, e.g., U.S. DOJ, <i>Criminal Tax Manual</i>, Chapter 41, http://www.justice.gov/tax/readingroom/2008ctm/CTM%20Chapter%2041.pdf.</p>
John Doe Summons	<p>A summons that does not identify the taxpayer under investigation because the name is not known. It must be approved by federal court before being served, with the IRS establishing that: (1) the summons relates to the investigation of a particular person or ascertainable group/class of persons; (2) a reasonable basis exists for believing that the person or class may fail or have failed to comply with tax laws; and (3) the information and identity of the person(s) is not readily available from other sources. 26 U.S.C. § 7609; see also <i>U.S. v. Powell</i>, 379 U.S. 48, 57-58, (1964) (enforcement of a tax summons is appropriate where the record shows, among other things, that “the investigation will be conducted pursuant to a legitimate purpose” and “the inquiry may be relevant to the purpose ...”).</p>
Title 31 Subpoena	<p>Can be used for civil enforcement of the Bank Secrecy Act and other specified laws. May be issued for the examination of such things as a financial institution’s current or former employees and its books and records. Cannot be used in a criminal investigation. See 31 U.S.C. § 5318(b)(1); IRS Internal Revenue Manual 25.5.11.</p>
Voluntary Compliance Initiatives	<p>IRS occasionally offers initiatives under which taxpayers may voluntarily disclose foreign assets without facing criminal penalties. See, e.g., IRS, <i>2011 Offshore Voluntary Disclosure Initiative</i>, http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-2.</p>
IRS Whistleblower Program	<p>Applies to an action against a taxpayer for tax underpayment or fraud when the amount in dispute (including tax, penalties, interest, etc.) exceeds \$2 million (and, if individual, gross income exceeds \$200,000). If the IRS proceeds with the action based on information brought to the agency’s attention by an individual, he or she may receive an award of between 15% and 30% of the collected proceeds resulting from the action or a settlement, with the amount depending on the extent to which the individual substantially contributed. Award can be limited to no more than 10% if a less substantial contribution, and it can be reduced if the individual planned and initiated the actions that led to the underpayment of tax or denied if he or she was convicted of criminal conduct arising from that role. 26 U.S.C. § 7623(b).</p>

Source: Congressional Research Service.

While these tools play an important role in addressing tax evasion relating to assets held overseas (see, for example, the UBS discussion below), their usefulness can be limited by information gaps, particularly when the information is held by a foreign party. For example, a whistleblower played a key role in the UBS case, thus perhaps raising the question of how the IRS might have fared absent his involvement. Tax treaties and TIEAs may be of limited use when another country's domestic laws restrict providing the information sought by the IRS or the treaty partner is unable to get the information. Additionally, thorny legal questions can arise when a U.S. court attempts to take action against an overseas party, for example, to enforce a subpoena. Furthermore, identified limitations in the Qualified Intermediary program include the lack of a requirement to report foreign source income and the ability for a corporation to be treated as a beneficial owner, both of which might allow U.S. taxpayers to avoid discovery (e.g., by setting up a foreign shell corporation to receive the income).¹⁹ These shortcomings played a role in influencing FATCA's reporting requirements for FFIs and other foreign entities.²⁰

UBS: A Case Study²¹

The IRS's actions with respect to the Swiss bank UBS illustrate how the IRS can use the various authorities identified in **Table I**. In 2007, Bradley Birkenfeld, a former UBS banker, began disclosing information to the IRS about the bank's accounts. In May 2008, he was arrested for failing to disclose information on a large account, to which he pled guilty and was subsequently sentenced to 40 months in prison.

Meanwhile, in June 2008, the IRS filed a John Doe summons with a U.S. district court, asking that UBS be required to disclose its U.S. customers who were potentially avoiding tax. The court approved the serving of the summons, but UBS refused to comply, arguing it could not disclose customer information under Swiss law.

The U.S. Department of Justice (DOJ) also began pursuing criminal charges against UBS for tax evasion, among other things. In February 2009, UBS agreed to a deferred prosecution agreement for the criminal charges, which called for a \$780 million fine and the disclosure of certain accounts. DOJ then filed a motion to enforce the John Doe summons, but UBS continued to refuse to comply, citing to Swiss law.

In August 2009, the IRS and DOJ announced an agreement with UBS and Switzerland, under which the IRS would submit a request under the U.S.-Swiss income tax treaty to the Swiss government describing the approximately 4,500 accounts for which it was requesting information. The Swiss government would then direct UBS to initiate procedures to turn over the information to the IRS.

Shortly thereafter, the IRS announced a voluntary compliance initiative, under which approximately 14,700 U.S. taxpayers came forward and disclosed their foreign accounts, apparently due in part to concerns they would be disclosed under the UBS settlement or that their information would be disclosed by other sources.

In September 2012, Mr. Birkenfeld, shortly after serving 2.5 years in prison, was awarded \$104 million under the IRS whistleblower program.

¹⁹ See, e.g., J. Richard Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and its Potential Future*, 57 VILL. L. REV. 471, 475-76 (2012); Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529, 532-33 (2012).

²⁰ See, e.g., Harvey, 57 VILL. L. REV. at 480-82; Peter Nelson, *Note: Conflict of Interest: Resolving Legal Barriers to the Implementation of the Foreign Account Tax Compliance Act*, 32 VA. TAX REV. 387, 391-92 (2012).

²¹ See Dep't of Justice, *UBS Enters into Deferred Prosecution Agreement, Bank Admits to Helping U.S. Taxpayers Hide Accounts from IRS; Agrees to Identify Customers & Pay \$780 Million* (Feb. 18, 2009); IRS, *IRS to Receive Unprecedented Amount of Information in UBS Agreement*, IR-2009-75 (Aug. 19, 2009); IRS, *Excerpts from IRS Commissioner Doug Shulman's Press Remarks on UBS* (Aug. 19, 2009); Lynnley Browning, *14,700 Disclosed Offshore Accounts*, NY TIMES (Nov. 17, 2009); David Voreacos, *UBS Tax-Fraud Charge Is Dropped by U.S. Prosecutors*, BLOOMBERG (Oct. 22, 2010); David Kocieniewski, *Whistle-Blower Awarded \$104 Million by I.R.S.*, NY TIMES (Sept. 11, 2012).

FATCA: Reporting for Foreign Entities

FATCA imposes reporting and other obligations on foreign financial institutions and other foreign entities. The following provides a general discussion of these provisions, focusing on the statutory requirements. The IRS finalized regulations under FATCA in 2013 (these have been modified several times)²² and has issued other guidance, all of which provide important details, the analysis of which is largely outside the scope of this report.

For these purposes, a financial institution is defined broadly to include entities that accept deposits in the ordinary course of a banking or similar business; holds financial assets for the account of others as a substantial portion of its business; or is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such; and certain insurance companies and other entities.²³ Thus, FFIs include not only banks, but also such entities as investment funds, hedge funds, private equity funds, broker-dealers, and insurance companies.

Foreign entities that are not financial institutions are called non-financial foreign entities (NFFEs) and may also be subject to reporting requirements.²⁴

Withholding Requirement

Before discussing FATCA's reporting requirements for FFIs and NFFEs, it is useful to understand how they are enforced. If the FFI requirements are not met, then a withholding agent²⁵ making a withholdable payment to an FFI must withhold tax from the payment at a rate of 30%.²⁶ Similarly, if the NFFE requirements are not met, a withholding agent making a withholdable payment to an NFFE must generally withhold 30% of the payment if the beneficial owner of the payment is the NFFE or another NFFE.²⁷

A withholdable payment is

- 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 U.S. sources; and
- the gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from U.S. sources; but

²² U.S. Dep't of the Treasury & IRS, 77 Fed. Reg. 9022 (Feb. 15, 2012) (notice of proposed rulemaking); 78 Fed. Reg. 5874 (Jan. 28, 2013) (final regulations); 78 Fed. Reg. 55202 (Sept. 10, 2013) (corrections to final regulations); 79 Fed. Reg. 12812 (March 6, 2014) (amendments to final regulations and temporary regulations).

²³ 26 U.S.C. § 1471(d)(5); 26 C.F.R. § 1471-5(e).

²⁴ 26 U.S.C. § 1472.

²⁵ Withholding agents are "all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment." 26 U.S.C. § 1473(4).

²⁶ 26 U.S.C. § 1471(a).

²⁷ 26 U.S.C. § 1472(a).

- does not include income effectively connected with a U.S. trade or business.²⁸

Various exemptions and special rules exist. For example, FFI withholding does not apply if the payment's beneficial owner is a foreign government, international organization, foreign central bank of issue, or any other class of persons identified by the Treasury Secretary as posing a low risk of tax evasion.²⁹ The NFFE requirement has a broader list of exemptions, as it also includes a corporation whose stock is regularly traded on an established securities market,³⁰ among others.

Credit and Refund

The rate of withholding is 30%, even if the withholdable payment would, under a tax statute or treaty, otherwise be exempt from U.S. income tax or subject to a reduced withholding rate.³¹ In general, the amount withheld may be credited against the U.S. income tax liability of the payment's beneficial owner, with the taxpayer receiving a refund to the extent the amount exceeds such liability. In order to be credited or receive a refund, an NFFE must provide to the IRS the information necessary to determine whether it (or another NFFE if it is the payment's beneficial owner) is a U.S. owned foreign entity and, if so, the identity of any substantial U.S. owners.

- **U.S. owned foreign entity:** any foreign entity with at least one substantial U.S. owner.
- **Substantial U.S. owner:** (1) for a corporation, a specified U.S. person who owns more than 10% of its stock; (2) for a partnership, a specified U.S. person who owns more than 10% of its profits or capital interests; (3) for a trust, certain owners (e.g., grantors) and any specified U.S. person who holds more than 10% of the trust's beneficial interests. For any financial institution that is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities (or any interest in such), the threshold is owning any percentage of interest.
- **Specified U.S. person:** generally means any U.S. person, but does not include a corporation whose stock is regularly traded on an established securities market, individual retirement plan, and certain investment vehicles and trusts, among others.

FFIs that fail to comply with the reporting requirements are subject to stricter rules. They may only be credited or receive a refund to the extent the exemption or reduced rate applies due to an income tax treaty. In such case, the FFI must provide information to the IRS to determine whether the beneficial owner is a U.S. owned foreign entity and the identity of any substantial U.S. owners. FFIs are not entitled to interest on the overpayment.

²⁸ 26 U.S.C. § 1473(1).

²⁹ 26 U.S.C. § 1471(f).

³⁰ 26 U.S.C. § 1472(c)(1).

³¹ 26 U.S.C. § 1474(b).

Reporting Requirements

In order to avoid being subject to withholding, the FFI or NFFE must report certain information focused on identifying U.S. account holders or U.S. owners of foreign entities.

Foreign Financial Institutions

For FFIs, no withholding occurs on its payments if an agreement is in place between the FFI and IRS under which the FFI agrees:³²

- To obtain information on each account holder as is necessary to determine which accounts are U.S. accounts.
 - **U.S. account:** in general, a financial account held by at least one specified U.S. person or U.S. owned foreign entity (both defined above). The term does not include, unless the FFI elects otherwise, any depository account if each holder is a natural person and the aggregate value of all depository accounts held by the holder does not exceed \$50,000.
 - **Financial account:** in general, any depository or custodial account maintained by the FFI and any equity or debt interest in the FFI (not including interests regularly traded on an established securities market)
- To comply with verification and due diligence procedures with respect to the identification of U.S. accounts.
- To annually report information on each U.S. account—including the name, address, and taxpayer identification number (TIN) of each account holder who is a specified U.S. person and, if the account holder is a U.S. owned foreign entity, the identifying information of each substantial U.S. owner of such entity; the account balance; and the gross receipts and gross withdrawals/ payments.
- In any case in which foreign law would prevent the reporting of any information on U.S. accounts, to either obtain a waiver of such law from the account holder(s) and, if a waiver cannot be obtained in a reasonable time, to close the account.
- To deduct and withhold 30% of any passthru payment the FFI makes to a recalcitrant account holder or a non-FATCA compliant FFI.
 - **Passthru payment:** any withholdable payment or other payment to the extent attributable to a withholdable payment.
 - **Recalcitrant account holder:** an account holder who fails to comply with reasonable requests for information or fails to provide the waiver of foreign law (described above) upon request.
 - An FFI may elect to be withheld upon rather than withhold on payments to recalcitrant account holders and non-FATCA compliant FFIs so long as the FFI agrees to provide relevant information to the withholding agent and waives any treaty right with respect to the amount withheld.

³² 26 U.S.C. §§ 1471(b), 1473. *See also* 26 U.S.C. § 1471(e) (treatment of affiliated groups); § 1471(c)(2) (providing election to be subject to same reporting as U.S. financial institutions, in which case different provisions apply).

- To comply with IRS requests for additional information with respect to U.S. accounts.

Various exceptions and other special rules exist. For example, certain FFIs will be deemed to meet the reporting requirements, including any that are a member of a class of institutions for which the Treasury Secretary has determined application of the requirements is not necessary to carry out FATCA's purposes.³³

Non-Financial Foreign Entities (NFFEs)

For NFFEs subject to withholding, no withholding occurs if the NFFE (or the payee) provides the withholding agent with a certification that the NFFE does not have any substantial U.S. owners or, if it does, the name, address, and TIN of each substantial U.S. owner.³⁴ The withholding agent cannot know, or have reason to know, that any of the information is incorrect and must report the information to the IRS.

Selected Legal Issues

Bilateral Intergovernmental Agreements

Since FATCA's passage, there has been criticism of the FFI and NFFE provisions and how they relate to other countries, generally focused on whether the United States was correct to take FATCA's unilateral approach. Questions have been raised about such things as whether FATCA's requirements are inconsistent with existing U.S. treaty obligations; how to handle potential conflict of law issues arising when an FFI is faced with complying with FATCA or its home country's domestic (e.g., banking and privacy) laws; and whether the United States has intruded into other countries' sovereignty.³⁵ These concerns, and the extent to which they may influence international views of FATCA, could be particularly important because it has been argued that FATCA's successful implementation would likely require the assistance of other countries.³⁶

The Treasury Department and IRS have reached out to other countries and entered into bilateral intergovernmental agreements (IGAs) with some of them. In general, the agreements provide that the other country's FFIs will be deemed to comply with FATCA's requirements if they follow the agreement, which means they would not be subject to withholding on payments received or the requirements related to recalcitrant account holders (i.e., withholding or closing the account). If

³³ 26 U.S.C. § 1471(b)(2).

³⁴ 26 U.S.C. § 1472.

³⁵ See, e.g., Arthur J. Cockfield, *The Limits of the International Tax Regime as a Commitment Protector*, 33 VA. TAX REV. 59 (2013); Peter Nelson, *Note: Conflicts of Interest: Resolving Legal Barriers to the Implementation of the Foreign Account Tax Compliance Act*, 32 VA. TAX REV. 387 (2012); Scott D. Michel and H. David Rosenbloom, *FATCA and Foreign Bank Accounts: Has the U.S. Overreached?*, TAX NOTES at 709 (May 30, 2011); Don Whiteley, *Canada Capitulates on FATCA Agreement*, BCBUSINESS (Feb 7, 2014), <http://www.bcbusiness.ca/finance/canada-capitulates-on-fatca-agreement>.

³⁶ See, e.g., J. Richard Harvey, Jr., *Offshore Accounts: Insider's Summary of FATCA and its Potential Future*, 57 VILL. L. REV. 471, 488-89, 494-98 (2012); Susan C. Morse, *Ask for Help, Uncle Sam: The Future of Global Tax Reporting*, 57 VILL. L. REV. 529, 537 (2012); Joanna Heiberg, *Note: FATCA: Toward a Multilateral Automatic Information Reporting Regime*, 69 WASH & LEE L. REV. 1685, 1706-1710 (2012).

the FFI does not comply with the IGA (and FFI agreement, if applicable), then it is subject to withholding if the IRS lists it as a nonparticipating financial institution.

There are two model IGAs, with some main differences summarized in **Table 2**. There are different versions of each model, depending on whether the United States has an existing tax treaty or tax information exchange agreement (TIEA) with the other country. In cases where there is an existing tax treaty or TIEA, the model agreement generally uses the treaty or TIEA as the authority for the IGA's requirements and links its practices and procedures to those developed under the treaty or TIEA. Additionally, there are different versions of Model 1, depending on whether the agreement calls for the reciprocal exchange of information between the United States and the other country.³⁷ Model 2 has no reciprocal exchange provision.

Table 2. Summary of Selected Differences Between FATCA IGAs Models 1 and 2

	Model 1	Model 2
To whom does the FFI report information?	To the home country's taxing authority, who then annually reports information to the IRS.	To the IRS. FFI must obtain consent of the account holder or nonparticipating FFI to disclose identifying information; if no consent is given, then FFI reports aggregate account information and the IRS can request information about the group from the other country.
Is there a reciprocal exchange of information with U.S.?	Agreement may call for it; if so, the information must be exchanged annually on an automatic basis.	No
Must the FFI have an FFI agreement?	No, but it must register on IRS's website and comply with IGA's reporting requirements.	Yes and register on IRS's website.
What are the due diligence requirements?	Agreement contains simplified due diligence requirements, but can choose to use those in Treasury regulations.	Same, but if chooses to use regulations' requirements, then must continue to use them unless material modification to regulations. FFI agreement has due diligence requirements.
Must FFI withhold on payments to recalcitrant account holders or must close account?	No requirement to withhold or close recalcitrant account so long as IRS receives information from the other country.	No requirement to withhold or close recalcitrant account unless the other country fails to respond within 6 months to a group request from the IRS for information about non-consenting accounts, then the FFI is required to withhold on those accounts.
What happens if significance noncompliance by FFI?	Other country applies its domestic laws to address the non-compliance, and if not resolved within 18 months, the IRS may treat the FI as nonparticipating.	If not resolved within 12 months, the IRS may treat the FFI as nonparticipating.

Source: Congressional Research Service, based on Model Agreements found at Dep't of Treasury, *Resource Center, Foreign Account Tax Compliance Act*, <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>.

³⁷ The model agreements are available at the Dep't of Treasury, *Resource Center, Foreign Account Tax Compliance Act*, <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>.

Since 2012, the United States has entered into agreements with 24 countries, which are listed in **Table 3**. Additionally, the Treasury Department has indicated that it is engaged in discussions for IGAs with Argentina, Australia, Belgium, Cyprus, Estonia, Israel, Korea, Liechtenstein, Malaysia, New Zealand, the Slovak Republic, Singapore, and Sweden.³⁸ The agency also stated it is “working to explore options for intergovernmental engagement” with Brazil, the British Virgin Islands, the Czech Republic, Gibraltar, India, Lebanon, Luxembourg, Romania, Russia, Seychelles, Saint Maarten, Slovenia, and South Africa.³⁹

Table 3. Countries With Which the United States has FATCA Agreements

Country	Date Agreement Signed	Type of Agreement
Bermuda	Dec. 19, 2013	Model 2, existing TIEA
Canada	Feb. 5, 2014	Model 1, existing treaty, reciprocal
Cayman Islands	Nov. 29, 2013	Model 1, existing TIEA, non-reciprocal
Chile	March 5, 2014	Model 2, existing treaty
Costa Rica	Nov. 26, 2013	Model 1, existing TIEA, reciprocal
Denmark	Nov. 19, 2012	Model 1, existing treaty, reciprocal
Finland	March 5, 2014	Model 1, existing treaty, reciprocal
France	Nov. 14, 2013	Model 1, existing treaty, reciprocal
Germany	May 31, 2013	Model 1, existing treaty, reciprocal
Guernsey	Dec. 13, 2013	Model 1, existing TIEA, reciprocal
Hungary	Feb. 4, 2014	Model 1, existing treaty, reciprocal
Ireland	Jan. 23, 2013	Model 1, existing treaty, reciprocal
Isle of Man	Dec. 13, 2013	Model 1, existing TIEA, reciprocal
Italy	Jan. 10, 2014	Model 1, existing treaty, reciprocal
Japan	June 11, 2013	Model 2, existing treaty
Jersey	Dec. 31, 2013	Model 1, existing TIEA, reciprocal
Malta	Dec. 16, 2013	Model 1, existing treaty, reciprocal
Mauritius	Dec. 27, 2013	Model 1, existing TIEA, reciprocal
Mexico	Nov. 19, 2012	Model 1, existing treaty, reciprocal
Netherlands	Dec. 18, 2013	Model 1, existing treaty, reciprocal
Norway	April 15, 2013	Model 1, existing treaty, reciprocal
Spain	May 14, 2013	Model 1, existing treaty, reciprocal
Switzerland	Feb. 14, 2013	Model 2, existing treaty
United Kingdom	Sept. 12, 2012	Model 1, existing treaty, reciprocal

Source: Congressional Research Service, based on U.S. Treasury Department’s FATCA Resource Center, <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>.

³⁸ Dep’t of Treasury, *U.S. Engaging with More than 50 Jurisdictions to Curtail Offshore Tax Evasion* (Nov. 8, 2012), <http://www.treasury.gov/press-center/press-releases/Pages/tg1759.aspx>.

³⁹ *Id.*

Deadline Extensions

FATCA's FFI and NFFE requirements have also been criticized as overly burdensome, and stakeholders have indicated they have insufficient time to prepare for the new reporting regime.⁴⁰

The IRS has responded by extending various deadlines under FATCA. The 2010 law enacting FATCA's FFI and NFFE requirements provides that, in general, "the amendments made by this section shall apply to payments made after December 31, 2012."⁴¹ In July 2011, the IRS released a notice that provided a timeline for implementing some of the act's requirements.⁴² For example, the notice provided that certain reporting requirements would start in 2014, and that the withholding requirements would begin on January 1, 2014, and be fully phased in on January 1, 2015. The notice explained the reasons for the phased-in implementation:

Treasury and the IRS have received numerous comments concerning the practical difficulties in implementing aspects of the Chapter 4 rules within the time frames provided in the Act and under Notice 2010-60 and Notice 2011-34. The challenges identified relate to the time to develop compliance, reporting, and withholding systems necessary to comply with Chapter 4 and the implementing notices. In addition, a number of stakeholders have noted that complying with certain provisions may require coordination with a number of foreign governments. Treasury and the IRS have met with stakeholders and foreign governments to understand the specific administrative and legal challenges that must be addressed and the time necessary to do so. While the Act provides that the provisions of Chapter 4 are effective beginning in 2013, Treasury and the IRS have determined that because Chapter 4 creates the need for significant modifications to the information management systems of FFIs, withholding agents, and the IRS, it is reasonable for regulations to provide for a phased implementation of the various provisions of Chapter 4.⁴³

The IRS subsequently issued proposed regulations in February 2012⁴⁴ and in October 2012 released an announcement that extended an additional deadline, citing to practical concerns with the proposed regulations' time frames.⁴⁵ The announcement explained that

The Treasury Department and the IRS have received comments identifying certain practical issues in implementing the chapter 4 rules within the time frames prescribed in the proposed regulations. In particular, comments have noted that the chapter 4 status of entity account holders may change during 2013 as FFIs enter into FFI agreements with the IRS, with the result that withholding agents that put in place new account opening procedures by January

⁴⁰ See, e.g., discussion *infra* notes 41 to 45, and surrounding text. Some have claimed that FATCA's provisions are leading foreign banks and other entities to close U.S. accounts or otherwise limit their services to U.S. citizens, although the extent to which this may be occurring is unclear. See, e.g., Nat Rudarakanchana, *Americans Abroad Can't Bank Smoothly As FATCA Tax Evasion Reform Comes Into Play*, INT'L BUS. TIMES (Dec. 20, 2013), (discussing the issue, but noting "[t]he extent of the problem is unclear, however, since there is no data on how widespread the banking disruptions are"), <http://www.ibtimes.com/americans-abroad-cant-bank-smoothly-fatca-tax-evasion-reform-comes-play-1517032>; Helena Bachmann, *Swiss Banks Tell American Expats to Empty Their Accounts*, TIME WORLD (Dec. 20, 2013), <http://world.time.com/2013/12/20/swiss-banks-tell-american-expats-to-empty-their-accounts/>.

⁴¹ P.L. 111-147 Title V, Subtitle A, § 501(d) (26 U.S.C. § 1471 note).

⁴² IRS Notice 2011-53, 2011-2 C.B. 124.

⁴³ *Id.*

⁴⁴ Dep't of the Treasury, IRS, *Notice of Proposed Rulemaking, Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities*, 77 Fed. Reg. 9,022 (Feb. 15, 2012).

⁴⁵ IRS, Announcement 2012-42, 2012-47 I.R.B. 561.

1, 2013, could be required to undertake duplicative efforts to verify an FFI's status as a participating, deemed-compliant, or nonparticipating FFI. Furthermore, comments have indicated that global financial institutions intend to implement uniform due diligence procedures for all affiliates. Accordingly, these comments have suggested aligning the timelines for due diligence for U.S. withholding agents, FFIs in countries with Intergovernmental Agreements, and FFIs in countries without Intergovernmental Agreements in order to significantly reduce administrative burden.⁴⁶

In July 2013, the IRS issued another notice, extending the effective date for withholding on some payments to July 1, 2014.⁴⁷

It might be asked whether the IRS has the authority to delay FATCA in light of the statutorily imposed effective date. In promulgating the regulations, the IRS generally cited to IRC Section 7805, as well as to the FFI and NFFE statutory provisions, IRC Sections 1471-1474. Section 7805 provides the Treasury Secretary with the authority to promulgate "all needful rules and regulations for the enforcement of" the IRC.⁴⁸ Section 1474(f), in particular, expressly gives the Treasury Secretary the authority to "prescribe such regulations or other guidance as may be necessary or appropriate to carry out the purposes of, and prevent the avoidance of, this chapter [IRC Sections 1471-1474]."

On the one hand, it might be argued that the deadline extensions, by providing more time to address the technical and similar issues related to FATCA's implementation, are the type of matters that Congress has left to the IRS to address by giving the agency its rulemaking authorities.⁴⁹ On the other hand, it might be argued that the IRS was overstepping its bounds in light of the statute's plain language regarding FATCA's effective date.⁵⁰ How a court might evaluate the merits of whether the IRS has authority to extend the deadlines may be difficult to predict at this time. For example, as a threshold matter, there may be a question as to who would challenge the IRS's decision to provide additional time to prepare for FATCA and whether any potential litigant would be personally injured—a necessary prerequisite to have standing—by it.⁵¹

⁴⁶ *Id.*

⁴⁷ IRS, Notice 2013-43, 2013-2 C.B. 113 (July 12, 2013).

⁴⁸ The IRS has also cited to its authority under Section 7805(a) in response to questions about whether it can provide transition relief delaying certain tax provisions of the Affordable Care Act (ACA). *See* Letter from Assistant Secretary Mark J. Mazur to Chairman Fred Upton (July 9, 2013) at <http://democrats.energycommerce.house.gov/sites/default/files/documents/Upton-Treasury-ACA-2013-7-9.pdf>.

⁴⁹ *See, e.g.,* Bob Jones Univ. v. United States, 461 U.S. 574, 597 (1983) (explaining, while examining Section 7805(a), "Congress cannot be expected to anticipate every conceivable problem that can arise or to carry out day-to-day oversight," and so "it relies on the administrators and on the courts to implement the legislative will"). As mentioned, the IRS has cited to Section 7805(a) as its authority to provide transition relief delaying certain ACA provisions. *See* source *supra* note 47.

⁵⁰ *See, e.g.,* Jeremy Scott, *The Power to Delay*, TAX ANALYSTS BLOG, July 29, 2013, <http://www.taxanalysts.com/taxcom/taxblog.nsf/Permalink/JSCT-9A3LWD?OpenDocument> (questioning whether the IRS has the authority to bypass statutorily imposed effective dates under FATCA); *see also* Hope v. United States, 803 F.2d 816 (5th Cir. 1986) (explaining, in the context of § 7805(a), "[a]lthough this Court owes deference to the agency construction of a regulation ... we also recognize that the agency regulation may not amend the statute").

⁵¹ *See, e.g.,* DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 344-45 (2006) (individuals generally do not have standing in their status as taxpayers to bring suit for allegedly unlawful taxation because any injury is too generalized and remote); *see also* CRS Legal Sidebar WSLG582, Obama Administration Delays Implementation of ACA's Employer Responsibility Requirements: A Brief Legal Overview, by (name redacted), (name redacted), and (name redacted) (discussing similar issues in the context of certain ACA delays).

FATCA Legislation in the 113th Congress

In the 113th Congress, several bills have been introduced that are related to FATCA. First, S. 887, whose stated purpose is “[t]o repeal the violation of sovereign nations’ laws and privacy matters,” would repeal many of FATCA’s provisions. The repealed provisions would be the reporting and withholding requirements on FFIs and NFFEs (IRC Sections 1471-1474); the reporting requirement for foreign financial assets (IRC Section 6038D); the extension of the statute of limitations for significant omissions of income in connection with foreign assets (IRC Section 6501(e)); the penalties for underpayments attributable to undisclosed foreign financial assets (IRC Section 6662(b)(7),(j)); the reporting requirements for activities with respect to passive foreign investment companies (IRC Section 1298(f)); the reporting requirement for U.S. owners of foreign trusts (IRC Section 6048(b); and the minimum penalty with respect to failure to report on certain foreign trusts (IRC Section 6677(a)).

Several bills include a provision with the purpose of “strengthening” FATCA—Stop Tax Haven Abuse Act, H.R. 1554, Section 102; Sequester Delay and Stop Tax Haven Abuse Act, H.R. 3666, Section 202; Stop Tax Haven Abuse Act, S. 1533, Section 102; and CUT Loopholes Act, S. 268, Section 102. In addition to the FATCA provision, these bills include numerous other provisions aimed at tax sheltering and avoidance activities. The FATCA provision would:

- Expand the reporting requirement for passive foreign investment companies, which currently applies to each U.S. person who is a shareholder of the entity, to include any U.S. person “who directly or indirectly forms, transfers assets to, is a beneficiary of, has a beneficial interest in, or receives money or property or the use thereof from.”
- Expand the definition of “financial account” to include transaction accounts.
- Expressly include entities engaged in investing in derivatives and swaps in the definition of “financial institution.”
- For purposes of the NFFE requirements, specify that the requirement that the withholding agent not know or have reason to know that any information provided by the NFFE is incorrect would have to be “as a result of any customer identification, anti-money laundering, anti-corruption, or similar obligation to identify account holders,” and clarify that the withholding provision does not apply to, among others, “any other class of persons identified by the Secretary for purposes of this subsection *as posing a low risk of tax evasion....* (emphasis added).”
- For purposes of FFI and NFFE reporting and withholding requirements, the definition of “substantial U.S. owner” for corporations and partnerships would include any person owning the threshold amount of the entity is any person who owns, directly or indirectly *or as a beneficial owner* (emphasis added).
- For purposes of FFI and NFFE reporting and withholding requirements, would amend the existing confidentiality rules to provide “except that information provided under Sections 1471(c) or 1472(b) may be disclosed to any Federal law enforcement agency, upon request or upon the initiation of the Secretary, to investigate or address a possible violation of United States law.” Also, would clarify that the identity of an FFI is not subject to the IRC’s confidentiality statute if its agreement was terminated.

- Provide that for purposes of IRC Section 6038D, which applies to any person holding “an interest” in a specified foreign financial asset, this may be an ownership or beneficial ownership interest.

The provision would also create two rebuttable presumptions for purposes of any U.S. civil judicial or administrative proceeding to determine or collect tax involving non-FATCA institutions (i.e., FFIs that did not meet FATCA’s reporting requirements):

- that a U.S. person exercised control over an entity holding an account or having assets in a non-FATCA institution if the person directly or indirectly formed, transferred assets to, was a beneficiary of, had a beneficial interest in, or received money or property or the use thereof from the entity, and
- that any amount or thing of value received by a U.S. person from an account or an entity holding an account or assets in a non-FATCA institution constitutes income taxable in the year of receipt and any amount or thing of value paid or transferred by or on behalf of a U.S. person directly or indirectly to such an account or entity represents previously unreported income taxable in the year of transfer.

The presumptions could be rebutted by clear and convincing evidence establishing, for purposes of the first presumption, that such taxpayer exercised no control over the account or entity at the time in question and, for purposes of the second, such amounts or things of value did not represent income related to such person. Additionally, the provision would require that a court prohibit the introduction by the taxpayer of any foreign based document that is not authenticated in open court by a person with knowledge of such document, or any other evidence supplied by a person outside the jurisdiction of a U.S. court unless such person appears before the court. The provision would also establish rebuttable provisions for securities law purposes regarding control and beneficial ownership for non-FATCA institutions.

Finally, the Commission on Americans Living Abroad Act (H.R. 597) would establish a commission to study how federal laws and policies affect U.S. citizens living in foreign countries. Among other things, the commission would be required to study federal financial reporting requirements for a U.S. citizen living in a foreign country, including the requirements under 31 U.S.C. Section 5314, and federal policies and requirements that affect the ability of a U.S. citizen living in a foreign country to access foreign and domestic financial institutions, including requirements under FATCA. The commission would be required to report within one year of the act’s enactment on its findings and recommendations and then issue a second report within a year of the first on any administrative actions implemented pursuant to the commissions’ recommendations.

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