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U.S. Treasury Releases Model FATCA Intergovernmental Agreement

Background

In February 2012, Treasury issued a joint statement with France, Germany, Italy, Spain and the United Kingdom regarding plans for an intergovernmental approach to implement the Foreign Account Tax Compliance Act (FATCA). FATCA, a part of the Hiring Incentives to Restore Employment Act of 2010, provides for a withholding tax to enforce reporting requirements for certain U.S.-owned foreign accounts. Under FATCA, a withholding agent must withhold a 30 percent tax on any "withholdable payment" to a foreign financial institution (FFI) or nonfinancial foreign entity that fails to disclose required information to U.S.tax authorities on certain U.S. account holders (including U.S.-controlled foreign entities). On July 26, 2012, a model intergovernmental agreement (IGA), in reciprocal and nonreciprocal versions, was finally released. The model IGA reflects a serious and shared commitment to combating international tax evasion.

Description of the Model Agreement

The model IGA outlines a framework whereby an FFI reports information on U.S.-controlled accounts to the government where it is resident, followed by an exchange of the information between the foreign government and the United States, thus offering a solution to foreign legal restrictions that might prevent direct reporting to the IRS under FATCA. Under the reciprocal version, the United States would also collect and report information on accounts in U.S. financial institutions held by residents of "FATCA Partner" countries. Partners to a reciprocal IGA would be selected in part based on whether a country has adequate measures to protect and keep confidential information exchanged under the agreement. Nonreciprocal IGAs will be available only to countries with which the United States already has an income tax treaty or tax information exchange agreement.

Information requirements in the model IGA are phased in from 2013 to 2016. For 2013 and 2014, for reportable accounts, FFIs under the IGA must provide the account holder's name, address and U.S. taxpayer identification number; the account number; the name and identifying number of the FFI; and the account balance or value. Additional information on certain income of custodial accounts must be reported starting in 2015. As of 2016, FFIs will have to report gross proceeds in custodial accounts, gross interest paid or credited in depository accounts and gross amounts paid or credited with respect to other accounts if the FFI is the obligor or debtor. In general, information is to be exchanged within nine months after the end of the calendar year to which the information pertains; nonetheless, the deadline for reporting information for 2013 is September 30, 2015.

An annex to the model IGA delineates due diligence obligations for identifying reportable accounts. Similar to the proposed regulations, the annex provides different procedures depending on the value of the account, whether the owner is an individual or entity and whether the account is preexisting (maintained as of December 13, 2013) or new. Unlike the proposed regulations, for new individual accounts, FFIs must obtain a self-certification that allows the institution to determine whether the account holder is a U.S. person and confirm the certification's reasonableness.

Some concepts in the model IGA may have a different scope than under the proposed FATCA regulations issued in February 2012. For example, under the model, the term FFI apparently includes investment managers. The model IGA also offers relief with respect to due diligence and reporting requirements for certain insurance companies. FFIs in FATCA Partner countries will be treated as FATCA-compliant if they report information required under an IGA. Such FATCA-compliant FFIs would not have to withhold tax under FATCA for payments to nonparticipating FFIs or close recalcitrant accounts. Under the model IGA, the competent authorities are responsible for addressing noncompliance issues in their respective jurisdictions.

The United States expects to execute agreements based on the newly released model IGA soon. Treasury is also developing alternative intergovernmental approaches with Japan and Switzerland, which may further address issues for multinational FFIs. (Note that FFIs in countries without an agreement would be subject to the normal FATCA rules under Internal Revenue Code Sections 1471 through 1474 and any accompanying regulations.) As the effective date looms closer, noncompliant U.S. owners of foreign accounts should seriously consider how the FATCA regime, especially as implemented by IGAs, could affect them. Participation in the IRS' current, ongoing 2012 Offshore Voluntary Program, for instance, may present an attractive option to the potential consequences of noncompliance discovered as a result of FATCA reporting.

United States v. Williams – *A New Standard for "Willfulness" in FBAR Penalty Cases?*

In an unpublished opinion on July 20, 2012, the U.S. Court of Appeals for the Fourth Circuit held that a taxpayer had willfully violated Title 31 U.S.C. §5314, which requires U.S. persons to report interests in foreign financial accounts. The mechanism for reporting is Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR). The parties agreed that the taxpayer violated the reporting requirement by failing to timely file FBARs for two Swiss bank accounts in which he had financial interests. The issue was whether the taxpayer had done so *willfully* so as to justify imposition of the willful civil penalties (in this case, $100,000 per account) for failure to file FBARs. (Prior to the case, the taxpayer had pled guilty to tax evasion, admitting to unlawfully and willfully evading tax by filing fraudulent returns on which he did not divulge his interest in the accounts.) The district court found that the government failed to show that the taxpayer's failure to file FBARs was willful. The appellate court reversed.

The Fourth Circuit majority, invoking the clear error standard of review for issues of fact, concluded that the district court's finding was "plainly wrong." According to the court, the taxpayer's signature on his Form 1040 was prima facie evidence that he knew its contents, and Line 7a on Schedule B, which asks whether a taxpayer has an interest in a foreign account, put the taxpayer on inquiry notice of the FBAR requirement. The taxpayer's false answers and conscious effort to avoid learning the FBAR requirement, the court reasoned, amounted to a willful violation. The majority also explained that the taxpayer's position that he did not violate the FBAR requirement willfully was inconsistent with his plea admission to willfully failing to report the Swiss accounts as part of his tax evasion scheme.

The dissenting opinion criticized the majority for not adhering to the narrow scope of clear error review, claiming that the majority had merely substituted its judgment for that of the district court. The dissent observed that the evidence, especially the taxpayer's testimony, could plausibly support the lower court's conclusion. Finally, the dissent addressed the government's judicial and collateral estoppel arguments (which the majority did not reach), agreeing with the district court's determination that the taxpayer's guilty plea to tax evasion did not necessarily establish that he willfully failed to file FBARs.

While an unpublished opinion is not binding precedent, the appellate majority opinion introduces a troubling standard for taxpayers in FBAR penalty cases. The circuit court not only seemed to depart from the clear error standard of review, but also from precedent on the issue of "willfulness," requiring an evaluation of a given taxpayer's knowledge of the legal obligation violated. The court's holding that a line item on a tax return schedule may establish constructive knowledge of the FBAR requirement is distinctly alarming. Moreover, the court's holding raises questions on the applicability of the non-willful FBAR penalties and reasonable cause provisions of Title 31. The decision also creates some uncertainty for taxpayers who might be considering participation in the Offshore Voluntary Disclosure Program.

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