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## The New *World Wide Web*: FATCA Inspires a Global Effort to Fight Tax Evasion

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The rapid evolution of the Foreign Account Tax Compliance Act (“FATCA”)<sup>1</sup> from a U.S. driven effort to crack down on U.S. offshore tax evaders into an information reporting mechanism being considered for adoption throughout the European Union (“EU”) and many other countries is creating a new kind of *world wide web* that has the potential to ensnare virtually every financial institution, corporation, partnership and trust in the world, with little hope of escape. Banks, custodians, brokers, investment advisers, investment vehicles and other types of entities (herein referred to as “multinational corporations”) should be paying attention now, ignoring the risks at their own peril.

Other countries initially viewed FATCA as an extraterritorial imposition of U.S. law, because, in essence, FATCA gives non-U.S. entities the choice of either identifying and reporting offshore U.S. account holder information to the U.S. Internal Revenue Service or being subject to a 30% withholding tax on most types of U.S. source income. Consequently, FATCA has the effect of “deputizing” foreign entities to enforce U.S. tax laws. However, discussions between jurisdictions around the world and the U.S. Treasury on how to implement FATCA triggered a worldwide debate on how to resolve the global problem of tax evasion, and what benefits could be gained from the multilateral exchange of tax information between and among countries already gearing up for FATCA. The debate is now giving way to concrete proposals, as participants throughout the world recognize that the policy behind FATCA is consistent with preexisting principles of increased information sharing and transparency led by the EU and the Organisation for Economic Co-operation and Development (“OECD”). Several EU member states, the European Commission (“EC”), the G-8, the G-20, and the OECD have proposed separate initiatives to obtain and share information on offshore accounts and investments owned by domestic taxpayers. As a result, multinational corporations now face the real threat of having to comply with several new tax information reporting regimes and being “caught” in the new world wide web of tax information transparency initiatives.

This alert provides an overview of global proposals, plans, and legislation to fight offshore tax avoidance. Multinational corporations are strongly urged to assess their exposure to these proposals and determine what steps will be necessary to perform the requisite due diligence, reporting, and withholding applicable under each regime. Firms are also encouraged to register their concerns with authorities responsible for implementing each initiative as soon as possible before ambiguities or problems are crystallized into law.

### The Spider Awakens: The FATCA IGAs

The U.S. Treasury Department has long recognized the potential burden that FATCA would have on multinational corporations and foreign governments. On the same day that proposed FATCA regulations were announced, the Treasury Department stated that the U.S. and an initial set of



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countries (the UK, France, Germany, Italy, and Spain) would explore alternative methods of complying with FATCA. On July 26, 2012, the Treasury Department published a model intergovernmental agreement (“IGA”), an innovative method of allowing partner countries to comply with FATCA.

The FATCA IGAs were intended as a method of allowing multinational corporations to overcome local privacy and data protection laws while reducing their compliance burdens and direct interaction with the United States. However, the IGAs have now taken on a life of their own as a precedent template for the automatic exchange of tax information. This is especially true as negotiations of the FATCA IGAs have intensified in the months before the January 1, 2014 FATCA compliance date. The Treasury Department is in active discussions with over 75 countries interested in IGAs.

### How to Spin a Spider’s Web: The FATCA Pilot Program

On April 9, 2013, France, Germany, the UK, Italy, and Spain (the “European G-5”) announced their intention to enter into a “pilot” information exchange program based on FATCA. Since that date, several additional countries, including Belgium, the Cayman Islands, the Czech Republic, Denmark, Finland, Ireland, Mexico, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, and Sweden, have joined the pilot initiative.

The pilot program is significant because it represents an early commitment by the European G-5 and many other countries to counter tax evasion in their jurisdictions by using the model already established by the FATCA IGAs. In their letter to EU Commissioner Algirdas Šemeta, the European G-5 also emphasized that the IGAs represent a “step change in tax transparency” that would be promoted as the “new international standard...with the ultimate aim of agreeing on a multilateral framework.”<sup>2</sup>

It is clear that the European G-5 intended to build momentum for the development of a common, multilateral tax information exchange platform by promoting the FATCA pilot initiative. In fact, the UK has recently taken the step to implement agreements with its crown dependencies, such as Guernsey, Jersey, the British Virgin Islands, and the Cayman Islands, that are largely based off of FATCA.<sup>3</sup> By choosing the FATCA IGAs as the model for the pilot programs, these jurisdictions recognized the importance of following an established and common approach for minimizing tax evasion. Moreover, the agreement increased pressure on the European Union to pursue its own FATCA initiatives, such as amendments to the EU Savings Directive and the Administrative Cooperation Directive, as discussed below.

### Entanglement: The EC’s Amendments to the Administrative Cooperation Directive

On June 13, 2013, the EC announced a proposal for a Council Directive to expand the scope of the automatic exchange of tax information between EU member states on “dividends, capital gains, all other financial income and account balances.” In its proposal, the EU noted that past proposals, including the EU Savings Directive and the Administrative Cooperation Directive, were part of an early commitment by the EU to address tax fraud and evasion, but that member states “have now expressed a clear wish to go beyond current levels of cooperation.”<sup>4</sup>

The EC’s proposal (herein referred to as “EU FATCA”) is significant for several reasons. First, it heavily relies on the momentum built by FATCA for the automatic exchange of tax information among member jurisdictions. EU FATCA amends the preexisting Administrative Cooperation

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Directive by requiring the automatic exchange of information on dividends, capital gains, income generated with respect to assets held in a financial account, and any amount with respect to which the financial institution is the obligor or debtor, including redemption payments and account balances.<sup>5</sup> Other categories of income and capital which are currently exchanged upon request and only “if the information is available” will be reassessed for automatic exchange in 2017.<sup>6</sup> The shift to the automatic exchange of information can be interpreted as a sign of support for the free flow of tax information across borders, similar to what is envisioned under the FATCA IGAs.

Second, the preamble to EU FATCA clarifies that preexisting law prohibits an EU member state that provides “wider cooperation” to a non-EU country from refusing to provide such wider cooperation to an EU member state. This has important implications for EU member states such as the United Kingdom and Spain, which have already signed IGAs with the United States. Thus, several EU member states either now have or will have a legal obligation to provide the same level of “wider cooperation” on tax information exchange to other EU member states, presumably under the terms of EU FATCA once passed.

Third, it is clear the EC is pursuing EU FATCA in the context of a worldwide push for the automatic exchange of information. In its release, the EC notes that “with the world’s two largest economic blocks now pushing the automatic exchange of information, there has been a new shift in this direction in the global arena.”<sup>7</sup> The EC also notes that it will continue to push for the automatic exchange of information at the G-20 summit in September as part of a unified EU position to secure “higher international standards of tax good governance.”<sup>8</sup>

If adopted, EU FATCA would take effect in January 2015 and would be applicable to all taxable income earned after January 1, 2014.

## Blowing Away the Cobwebs: The EU Savings Directive

The European Union Savings Taxation Directive (“EUSTD”) is meant to ensure the effective taxation of savings income throughout the European Union and requires EU member states to report tax information on savings income. “Savings income” includes interest earned on bank deposits, interest from certain bonds and proceeds on their sale or redemption, and income from certain types of investment funds. The directive requires the EC to report to the European Council every three years on the effectiveness of EUSTD and propose any amendments that may be required to ensure effective taxation of savings income and remove undesirable distortions of competition.<sup>9</sup>

In 2008, several EU member states proposed to amend the EUSTD to expand the definition of savings income, close loopholes so as to make it more difficult to avoid reporting requirements, create facilities for the automatic exchange of tax information, and publish public registers of company ownership. Austria and Luxembourg successfully blocked these amendments for several years, but those two countries recently dropped their objections to the amendments in light of the growing momentum behind FATCA, the collapse of the banking system in Cyprus, and the need for tax revenue given increasing budget deficits in the EU.<sup>10</sup>

In May, the EU Economic and Financial Affairs Council reached an agreement on a mandate to allow the EC to negotiate amendments to the EUSTD. These amendments would extend the scope of the EUSTD to cover investment funds, pensions, additional financial instruments, and payments made through trusts and foundations. The European Council is committed to adopting the revised EUSTD by the end of this year.

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### The Daddy Long-Legs: The G-8 “Lough Erne Declaration” and “G-8 Leaders’ Communiqué”

On June 18, 2013, the G-8 concluded its summit in Lough Erne, Northern Ireland, and released its “Lough Erne Declaration” and “G-8 Leaders’ Communiqué,” setting forth the principles they agreed to during the conference. Members of the G-8 include the United States, France, Germany, Italy, Japan, the United Kingdom, Canada, Russia and the EU.

The Lough Erne Declaration sets forth 10 major themes, 4 of which commit the G-8 to cooperate on anti-tax evasion measures. Notably, the first declaration states that “tax authorities across the world should automatically share information to fight the scourge of tax evasion.”<sup>11</sup> Meanwhile, the G-8 Leaders’ Communiqué more explicitly supports the development of automatic information exchange systems and supports the OECD’s report on the implementation of a common standard for the multilateral automatic exchange of tax information (discussed below).<sup>12</sup> The G-8 calls upon “all jurisdictions to adopt and effectively implement this new single and global standard at the earliest opportunity.”<sup>13</sup>

The Lough Erne Declaration and the G-8 Leaders’ Communiqué are not legally binding, but they indicate that international anti-tax evasion efforts remain at the top of the agenda for the world’s leaders. G-8 President David Cameron noted that the Lough Erne Declaration “has the potential to rewrite the rules on tax and transparency for the benefit of countries across the world.”<sup>14</sup> This result was immediately apparent as several G-8 and non-G-8 countries announced national action plans to address base erosion and profit shifting and automatic information exchange initiatives.

### As Patient as a Noiseless Spider: The OECD’s Model Template for the Exchange of Information

The OECD is actively pursuing a standard and uniform template for the multilateral automatic exchange of information. As described by the OECD, the automatic exchange of information would entail the systematic and periodic transmission of “bulk” taxpayer information on sources of income such as dividends, interest, salaries, and pensions.<sup>15</sup> The OECD hopes that a common standard for the automatic exchange of information will reduce the costs associated with collecting information through several different models.<sup>16</sup>

On April 19, 2013, the finance ministers and central bank governors from the G-20 endorsed the multilateral template concept and asked the OECD to pursue the endeavor. In its June 18 report, “A Step Change in Tax Transparency,” the OECD found that a single reporting model for the multilateral exchange of information would be feasible if the following four steps were taken:

1. *Enacting broad framework legislation to facilitate the expansion of a country’s network of partner jurisdictions*<sup>17</sup>

- For example, a jurisdiction enacting legislation to implement a Model I IGA could also adopt legislation to support the exchange of information with non-U.S. jurisdictions.

2. *Selecting or entering into a legal basis to support the exchange of information*<sup>18</sup>

- Jurisdictions will need to assess whether an existing bilateral treaty will support the exchange of information, or if it would be advisable to enter into a new multilateral information exchange instrument.

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### 3. *Adapting the scope of reporting and due diligence requirements and coordinating guidance*<sup>19</sup>

- An agreement on matters such as the thresholds for the reporting of accounts, exceptions to reportable account holders, due diligence procedures, and exceptions to reporting financial institutions is necessary to support a common standard on the multilateral exchange of information.

### 4. *Developing common or compatible information technology standards*<sup>20</sup>

- A uniform reporting format based on a secure data exchange process is necessary for the multilateral exchange of sensitive tax information.

It is important to note that the OECD's *Step Change* report relies heavily on FATCA, with a particular emphasis on the Model I IGAs. In addition, Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration of OECD, has noted that other countries have pushed for the same level of tax information transparency created by FATCA as they contend with issues relating to base erosion and profit shifting.

There are several major assumptions in the OECD's *Step Change* report that may impede the adoption of a common multilateral exchange of information facility. One obstacle is the adoption of common reporting and due diligence requirements and coordinating guidance. While many jurisdictions have agreed in principle that offshore accounts should be identified and reported to domestic tax authorities, it can be safely assumed that there will be a substantial amount of disagreement on accounts and institutions exempt from the identification and reporting or the required scope of due diligence. The OECD will need to resolve these differences at an early stage in order to develop a multilateral exchange facility that will be accepted on a global basis. One option may be to use areas of common agreement between FATCA and the various EU proposals as a launch point for future discussion.

We also note that the OECD's *Step Change* report recommendation to adopt broad legislation to enter into a multilateral tax information exchange instrument may be one reason why the IGA process has slowed in recent months. Rather than conclude an IGA and request authorizing legislation now, it seems more logical that a country would wait until other tax information exchange agreements are concluded before seeking authorization to enter into multiple agreements. If so, it may be possible that several jurisdictions will not sign IGAs with the U.S. until well after the January 1, 2014 effective date of FATCA.

## A Disintegrating Web? Opposition to FATCA Intensifies

While countries throughout the world begin to sign IGAs and develop additional tax information transparency initiatives, domestic opposition has increased. In the U.S., Senator Rand Paul (R-KY) has introduced S. 887, which would repeal the majority of FATCA. Senator Paul argues that FATCA's law enforcement benefits are outweighed by its effects on growth and the financial privacy of Americans and allows the Treasury Department to make independent decisions regarding the sovereignty of foreign nations and the privacy of U.S. citizens. While S. 887 is not expected to have an effect on FATCA implementation, it does highlight growing resistance in the U.S. against the transparency and disclosure requirements of the legislation.

Internationally, the ratification of FATCA IGAs has also been a challenge. In Switzerland, members of the Swiss Parliament have vocally opposed providing account information to the IRS through FATCA, and a vote to implement the U.S.-Switzerland IGA has been delayed until September.<sup>21</sup> Meanwhile, several concerns have begun to arise with regard to the impact of the FATCA IGAs on preexisting EU data protection laws.

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Finally, there remains the possibility that the U.S., the EU, or another actor (such as China) could actively oppose a common standard for the automatic exchange of tax information as that model becomes finalized. That move could upset current international efforts to harmonize tax information exchange regimes and result in a “go it alone” approach for one or more countries.

### Conclusion: Caught in the Spider’s Web?

Few would have predicted that the FATCA, heavily criticized for its unilateral imposition of reporting, due diligence, and withholding requirements on foreign entities, would spark a global web of automatic tax information exchange regimes. The web is now being spun, but its creators have not yet agreed on its ultimate design. Several outstanding issues remain with all the FATCA proposals discussed in this alert, including the scope of reporting, exempt entities and payments, and a common implementation timeline.

Without coordination, multinational corporations will need to comply with a patchwork web of different legal regimes and obligations. On the other hand, a common multilateral model for the automatic exchange of tax information may leave foreign entities with “nowhere to hide,” as intended by the leaders of the G-8 and the EU. Consequently, we encourage all multinational corporations to examine these proposals, assess the potential risk, and design a compliance strategy for the new world wide web.

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<sup>1</sup> FATCA, originally proposed as stand-alone legislation, was enacted on March 18, 2010, as part of the Hiring Incentives to Restore Employment Act of 2010 ("HIRE Act"). This alert adopts the convention of using "FATCA" to refer to the withholding and information reporting provisions added as Sections 1471-1474, Chapter 4 of Subtitle A of the Internal Revenue Code of 1986, as amended.

<sup>2</sup> "G5 Letter to the European Commission April 2013," *available at* [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208068/g5\\_letter\\_to\\_european\\_commission\\_090413.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208068/g5_letter_to_european_commission_090413.pdf) (last accessed Jun. 25, 2013).

<sup>3</sup> "Implementing the United Kingdom's Agreements with the Crown Dependencies to Improve International Tax Compliance," HM Revenue & Customs, *available at* <http://www.hmrc.gov.uk/fatca/uk-crown-dependencies.pdf> (last accessed Jun. 25, 2013).

<sup>4</sup> Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM (2013) 348 (final), *available at* [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/tax\\_cooperation/mutual\\_assistance/direct\\_tax\\_directive/com\\_2013\\_348\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/mutual_assistance/direct_tax_directive/com_2013_348_en.pdf).

<sup>5</sup> "Automatic exchange of information: frequently asked questions," European Commission, *available at* [http://europa.eu/rapid/press-release\\_MEMO-13-533\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-533_en.htm) (last accessed Jun. 25, 2013).

<sup>6</sup> *Id.* These categories include income from employment, director's fees, pensions, life insurance products not covered by other EU laws on the exchange of information, and ownership of and income from immovable property.

<sup>7</sup> "Automatic exchange of information: frequently asked questions," European Commission, *available at* [http://europa.eu/rapid/press-release\\_MEMO-13-533\\_en.htm](http://europa.eu/rapid/press-release_MEMO-13-533_en.htm) (last accessed Jun. 25, 2013).

<sup>8</sup> *Id.*

<sup>9</sup> Article 18, Directive 2003/48/EC of the European Parliament and of the Council of 3 June 2003 Relating to Taxation of Savings Income in the Form of Interest Payments, *available at* <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:157:0038:0048:en:PDF> (last accessed Jun. 25, 2013).

<sup>10</sup> "France's Hollande: EU Savings Directive Will Be Adopted by Year-End," WALL ST. J., May 22, 2013, <http://online.wsj.com/article/BT-CO-20130522-709483.html>.

<sup>11</sup> "Lough Erne Declaration," The White House, Office of the Press Secretary, *available at* <http://www.whitehouse.gov/the-press-office/2013/06/18/lough-erne-declaration> (last accessed Jun. 25, 2013).

<sup>12</sup> "G-8 Leaders' Communiqué," The White House, Office of the Press Secretary, *available at* <http://www.whitehouse.gov/the-press-office/2013/06/18/g-8-leaders-communication>.

<sup>13</sup> *Id.*

<sup>14</sup> "G8 and tax avoidance: Q&A," THE GUARDIAN, June 19, 2013, *available at* <http://www.guardian.co.uk/business/2013/jun/19/g8-tax-avoidance-q-and-a>.

<sup>15</sup> "Automatic Exchange of Information," Organisation for Economic Co-Operation and Development, *available at* <http://www.oecd.org/ctp/exchange-of-tax-information/automaticexchange.htm> (last accessed Jun. 25, 2013).

<sup>16</sup> *Id.*

<sup>17</sup> "A Step Change in Tax Transparency – OECD Report for the G-8 Summit, Lough Erne, Enniskillen (June 2013), Pg. 10, *available at* [http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency\\_G8report.pdf](http://www.oecd.org/ctp/exchange-of-tax-information/taxtransparency_G8report.pdf).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at Pg. 12.

<sup>20</sup> *Id.* at Pg. 13.

<sup>21</sup> "Swiss Parliament's Upper House OKs FATCA Accord; Lower House to Vote in September," Daniel Pruzin, Bloomberg BNA Daily Report for Executives, *available at* [http://dailyreport.bna.com/drpt/7010/split\\_display.adp?fedfid=32429802&vname=dernotallissues&id=a0d9n4f3v0&split=0](http://dailyreport.bna.com/drpt/7010/split_display.adp?fedfid=32429802&vname=dernotallissues&id=a0d9n4f3v0&split=0) (subscription required).

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