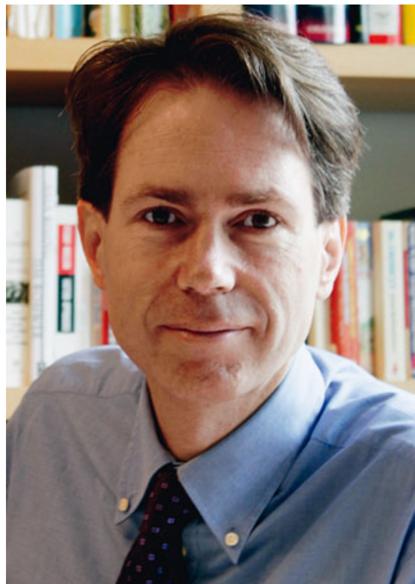
Fatca and the Road to International Automatic Information Exchange



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Introduction
2013 may enter history as the year privacy in personal financial affairs ended. With the Foreign Account Tax Compliance Act (Fatca) the United States is leading the way in regulating foreign financial institutions (FFIs) with tools and laws designed to force full cooperation with and disclosure to tax authorities. These measures are designed to achieve full financial information exchange on all offshore financial activities globally.

Fatca is designed to achieve three objectives: i) report both U.S. and foreign source income for U.S. taxpayers, ii) determine if U.S. taxpayers are the ultimate beneficial owners of foreign entities (shell companies, trusts, foundations) and iii) review of all customer accounts within an extended foreign financial institution group to identify U.S. taxpayers globally. We can expect other governments to adopt these or similar measures.

The joint statement with the governments of the UK, France, Germany, Italy and Spain announced an intergovernmental framework for Fatca implementation. Countries will enter agreements with the U.S. to collect information from financial institutions and automatically forward this to the IRS. Negotiations on defining the intergovernmental agreements (IGAs) are well under way with the U.S.–UK agreement signed on September 14.

All this is arguably pointing the way to a future of international cooperation and exchange on all financial information, not just tax. Each country would i) draft and implement legislation to require FFIs in its jurisdiction to collect and report to local authorities the information required under Fatca, ii) require FFIs to apply due diligence under Fatca to identify all U.S. account holders and iii) automatically transfer the information reported by the FFIs to the United States.

The road to full exchange
Phase 1 – Fatca: Participating countries pass information to the U.S., the U.S. reciprocates, passing information back to the countries on their residents' financial assets in the U.S. This achieves alignment of interests, providing incentives in the form of tax revenues, reporting, compliance and control. The U.S. is clearly signaling long-term intent with measures including the development of new customer due diligence rules, updating employer identification numbers (EINs) and updating W-8BEN to include non-US TIN.

Phase 2 – Bilateral agreements: Fatca, however is lop-sided; everyone talks to the IRS, the IRS talks back, but none of the Fatca partner countries talk to each other. Most likely a series of bilateral information exchange agreements will follow; we are in fact partly there already. Each country signs a bilateral agreement with every other country in the "Fatca Partner" network to exchange data. This, however, is likely to be highly complicated, time-consuming and expensive with each country negotiating separate deals.

Phase 3 – Full automatic information exchange: Centralization looks increasingly inevitable once each country is gathering data on financial account holders with local collection offices gathering and storing data. The Fatca framework then becomes the foundation for full automatic exchange of tax information across all OECD countries. All countries feed data into a central repository and each country is given access rights to its own citizens'/residents' data.

In a central repository model, each country is given access to its own citizens' account data, from whichever country that account happens to be in. Simple, powerful and scalable to include all OECD countries. Technically relatively simple, adding a particular country, once that country has decided to join, would be straightforward; it would simply be adding a "user".

The steps in the process would likely follow something like: i) financial institutions collect client account details, ii) individual financial institutions pass data to collection offices, iii) data is uploaded into the central repository, iv) each country's tax authorities access their own citizens' account details. Given the tax compliance and control benefits, public policy and necessary legislative changes are unlikely to slow the process down. Followed through to the logical conclusion, we are likely looking at the effective end of personal privacy in financial affairs in 10 to 15 years.

Conclusion
Fatca looks to be laying the groundwork for an international system of automatic information exchange. Implemented under a multilateral cooperation approach, where all participating countries share in the benefits and bear more or less equally the costs. This international approach aligning countries' interests and providing appropriate incentives, makes it not only possible, but we think, now inevitable.

Over the next few years clients will have to regularise their offshore financial affairs, assets must be declared to local tax authorities. Advisors will need to make better use of structures to protect and grow assets, while providing better disclosure on costs vs. benefits. Structures (trusts, foundations, LLCs, insurance etc.) will have to fill the needs. Therefore, the use of structures to protect and grow assets in a tax-compliant way will continue to increase. It is the task of advisors to adapt to the changes, learn and use compliant structures that make sense for the client and truly add value.

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