10. FATCA vs. AEI (Automatic Exchange of Information)

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FATCA is the abbreviation for the "Foreign Account Tax Compliance Act", which is part of the Hire Act. FATCA came into law in 2010. FATCA shall be implemented starting July 1, 2014. A question which has been asked frequently is, "will it really happen"? The answer is undoubtedly "yes".

Those who have criticized FATCA raised the argument that it will cost the international banking community 1,000 in order for the IRS to receive 1 of tax revenue. Although non-U.S. banks had to review their KYC and their reporting system if they want to be in a position to live up to FATCA requirements, it is fair to state that the U.S. has also invested considerable sums in the FATCA venture. They successfully negotiated and entered into a significant number of IGA Model 1 ("IGA" is the abbreviation for "intergovernmental agreement") and some IGA Model 2 Agreements (Switzerland, Japan and the Bermuda). Once implemented, FATCA will establish a new global standard in matters of cross-border exchange of information ("EoI").

In an attempt to protect Swiss banking secrecy, Switzerland has entered into an IGA Model 2 Agreement. With respect to preexisting accounts, U.S. Persons have to agree to the information being automatically released to the U.S. authorities. This consent will cover the respective current year and will automatically renew for each successive calendar year, unless revoked before the end of January of such year.

U.S. Persons are made aware of the fact that denying their approval to an automatic exchange of information ("AEI") concerning their U.S. TIN (Tax Identification Number), the account number and other identifying elements will entail that:

1) information about the account (aggregated with other accounts) will be reported to the IRS,
2) information about the account may give rise to a group request by the IRS for specific information about the account,
3) in such case, account information shall be transmitted to the Swiss Federal Tax Administration ("SFTA") and
4) the SFTA may exchange this information with the IRS in accordance with Article 5 of the IGA Model 2 Agreement.

IGA Model 2 temporarily protects U.S. Persons who have Swiss accounts and who do not consent reporting under FATCA. In these instances the U.S. authorities must revert to a group request if they want to overcome the veto of the bank customer.

The IGA Model 2 is an asymmetric and therefore not reciprocal legislation. While in Switzerland it had to go through parliament, in the U.S. it was valid and enforceable upon signing. From a U.S. perspective, an IGA is an intergovernmental agreement, which is valid as such. In the U.S. Senate, FATCA and/or the IGA Model Agreements have never been discussed. FATCA is essentially a one way street, where information flows from Switzerland to the IRS, but not vice versa. The major drawback of the IGA Model 2 is the direct reporting of Swiss Financial Institutions to the IRS. IGA Model 1 countries have to report to their competent authorities, who in turn will exchange information automatically with their U.S. counterparts. Swiss FIS under Model 2 have to enter into a binding agreement with a foreign revenue authority. A further disadvantage is the open ended definition of "foreign financial institutions". The term refers to all financial institutions that are organized pursuant to the laws of Switzerland. In order not to be caught in the category of the "Nonparticipating Financial Institutions ("NPFI") and subject to few exceptions, all Swiss banks, life insurance companies and Swiss investment entities (the "fiduciary companies") will have to register under FATCA and thus apply for a GIIN ("Global Intermediary Identification Number") regardless on as to whether they are doing business with U.S. persons or not.

Those who are blissfully unaware of worldwide importance of FATCA may have hoped that once the OECD has installed its AEI system, FATCA would go away by itself. This will most certainly not be the case. The U.S. have opted for FATCA a long time ago and are likely to stick with their choice, no matter what the OECD will be doing.

This means that in the foreseeable future, there will be at least two important exchange of information systems in place. FATCA, which, as far as U.S. accounts held in Switzerland are concerned, will only be an AEI system if the U.S. persons concerned give their approval as well as the OECD's Common Reporting System ("CRS"), a first draft of which was rendered public in February 2014. It may well be that once implemented, the OECD's CRS will be replacing the standard exchange of information provision contained in most double taxation conventions. This will, however, take time as the OECD's CRS is a model for bilateral conventions, which are likely to pass in the parliament of both countries participating. So for a certain time, there will be some countries with which there will be an AEI while for many other countries there will still be the traditional exchange of information provision in place. However, one needs to be aware that 58 States have signed the OECCD Mutual Agreement on Administrative Assistance which basically already paved the way for the international framework. The Agreement contains exchange of information upon request, automatic and spontaneous exchange of information clauses. Switzerland signed the Agreement on October 15, 2013 and it remains to be seen for how long the different systems will be maintained on parallel.

There is, however, another equally important player involved in this game. This is the EU. A few weeks ago, the EU released a draft for an amendment to its Savings Tax Directive (2003/48/EC). The EU Tax Commissioner Algirdas Semeta has called these amendments (http://euobserver.com/economic/120474)

"the most comprehensive information exchange system in the world to combat tax dodging".

The tax savings directive applies a paying agent system, which is contrary to the place of residence of the debtor that is applied by most DTC (as per Article 11 OECD MC). The words of the EU Tax Commissioner seem to indicate that if the U.S. has FATCA and the OECD has its CRS, the EU will keep its own EoI system alive, no matter what the other two players may be doing.

Brave New World! Let us assume that in a few years from now, FATCA will be in place, Switzerland will have entered into CRS conforming tax agreements (treaties?) with most EU Member States and Switzerland will also have adopted a revised Tax Savings Agreement with the EU. Let us further assume a plain vanilla situation in which a U.S. citizen who is a resident of an EU Member State (with which Switzerland will have entered into a CRS conforming EoI Agreement) has a bank account in Switzerland, on which he receives interest on bonds that have been issued by a Swiss resident debtor.

Under the amended EU Savings Tax Directive, i.e. the amended agreement with Switzerland, the Swiss bank in its function as a paying agent will automatically report the interest earned on the Swiss bonds to the EU country of which the U.S. citizen is a resident. Under the OECD's CRS (bilateral agreements that Switzerland will have entered into with most EU Member States), the same information regarding said U.S. person's Swiss account will once more be automatically exchanged between Switzerland and the U.S. person's EU place of residence. On top of that, and as we have assumed, for a U.S. citizen receiving interest on the bonds, which are deposited in a Swiss bank account, FATCA will apply. Subject to said U.S. person giving its consent, information will again be automatically exchanged, but this time between his Swiss bank and the IRS directly. The U.S. person, which we assume is eager to be fully compliant, will have to file all the applicable U.S. tax forms (including but not limited to the electronic replacement of the FBAR) in order not to contradict any of the information that has been automatically exchanged. Even worse: If under CRS it is established that this person shows indicia for residency in other countries (e.g. holiday home in Italy), there will be multiple reporting to the other EU country AND to Italy. Last, but not least, and as Switzerland levies a 35% withholding tax on the interest paid on the bonds issued by a Swiss resident debtors, the U.S. person will have to invoke the applicable double taxation treaty between Switzerland and the EU Member State in which he is a resident of, in order for him to benefit of the lower treaty rate (usually 15%).

Is there an overlap? Different countries receive information on said bank account, i.e. the U.S under FATCA, the EU Member State under OECD's CSR and, also in accordance with the Swiss Agreement, with the EU amending the Tax Savings Directive. As, however, there is no difference between a "paying agent" (EU) and "financial institution (OECD CRS), Switzerland has indicated that the discussions on the Amendment of the Tax Saving Agreement will be deferred until it is clear, where the OECD is heading for.

We shall remember the good old times, when this "battle of forms" was not in place as yet. In a not too distant future, many U.S. (and also many other) persons will have to seek professional advice in order to properly fill in all the tax forms being required under the circumstances. A simple question would consist of asking "could we not do (much) more with less"?

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