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FATCA

FATCA: Getting Rid of U.S. Clients Will Not Get You Off the Grid

Treasury and the IRS so anxious about the uncontrollable and unpredictable consequences of FATCA for many businesses, including U.S entities, that they are giving license to evade foreign taxes through the very same practice that they intended to curtail.

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The Foreign Account Tax Compliance Act (FATCA) is by now well known but to understand exactly what this monster Act is about, it is necessary to read between the lines. In a previous article,[1] I asserted that the global implementation and extraterritorial applicability of FATCA, a U.S. law, was reshaping the well-established international tax order as it has been know for decades, based on domestic international tax law and tax treaty law according to the U.N. Vienna Convention on the Law of Treaties (May 23, 1969), which requires internationally negotiated and agreed reciprocal treaty mechanisms for the applicability of another country's public law.

Many important aspects of FATCA are either unduly set aside, inadvertently overlooked, or simply misperceived. Do Treasury and the IRS have a clear picture of what they have led Congress to unleash on the global financial world? Does the government really want to make this world a "financial colony" of the United States? FATCA country partners, by agreeing to "help" the United States enforce FATCA within their territories, are surrendering some of their sovereignty, even if it occurs under the cover of negotiated intergovernmental agreements ("FATCA IGAs"), because they are implementing and enforcing FATCA within their jurisdictions without getting equal or identical reciprocity from the United States.

There are two options:

1 FATCA succeeds, with or without FATCA IGAs, and we welcome the world's first financial colonization, where an entity is either a compliant foreign financial institution (CFFI), as opposed to a participating foreign financial institution (PFFI), or an "ice-age" FFI—one that, except for local persons, not only does not take foreigners as clients because of the risk of onboarding U.S. persons, but does not even transact internationally because of the risk of receiving U.S.-source FATCA-related income, even as a passthru payment. In effect, through FATCA IGAs, FATCA country partners simply become U.S. foreign tax agencies.

2 Instead of FATCA accommodating IGAs, global account tax compliance treaties (GATCTs) are the basis of the international platform for global tax reporting and information exchange.[2]

FATCA: Reading Between the Lines

The discussion below focuses on aspects of FATCA that are misperceived, underreported, or inadvertently overlooked, which might lead to unsound advice. The analysis considers the Act itself and the Proposed Regulations.

Getting off the FATCA grid.

Under Sections 1471 and 1472 and the Proposed Regulations (REG-121647-10, February 8, 2012),[3] U.S. withholding agents are required to withhold a 30% tax on any withholdable payment[4] made to any FFI or non-financial foreign entity (NFFE) if they do not meet certain requirements. FFIs must be PFFIs, which means that they must enter into an agreement with the IRS before July 1, 2013, under which, among other things, the FFI will (1) apply FATCA-enhanced due diligence to identify U.S. persons and classify their customers among U.S. persons, non-U.S. persons, and recalcitrant account holders; (2) collect specific information

1 Mukadi, "FATCA and the Shaping of a New International Tax Order," Tax Notes Int'l, June 25, 2012, pages 1227-1233.

2 Article 6.3 (Development of Common Reporting and Exchange Model) of the recently released G5 Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA seems to lay ground for such an endeavor: "The parties are committed to working with other partners and the OECD, [and the EU] on adapting the terms of this Agreement to a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions." This is the conclusion that I reached in my previous article, where I suggested using the already existing OECD Model Tax Convention on Income and Capital ("OECD Model") and adapting it with FATCA principles as a basis for an international tax coordination platform. See note 1, *supra*, at 1233.

3 See O'Donnell, Gibson, Read, Georgiev, Michaels, Bennett, Daub, and Odintz, "FATCA Proposed Regulations—Is It Finally Becoming More Manageable?," 23 JOIT 22 (May 2012).

4 "Withholdable payment" refers to any U.S.-source fixed or determinable annual or periodical (FDAP) income or (starting January 1, 2014) any gross proceeds from the sale or other disposition of any U.S. property that can produce interest or dividends that are U.S.-source FDAP income. Prop. Reg. 1.1473-1(a).

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about U.S. persons and report it to IRS; and (3) withhold a 30% tax on passthru payments to nonparticipating FFIs (NPFFIs) and recalcitrant account holders. An NFFE will be subject to the 30% withholding tax if it has substantial U.S. owners but does not provide the withholding agent with their names, addresses, and taxpayer identification numbers (TINs), or fails to establish that it does not have any substantial U.S. owner.

There are several exceptions to the FATCA requirements, including obligations that are grandfathered,[5] individual U.S. persons and U.S. entities with balances in their foreign accounts less than a specified amount,[6] FFIs that are deemed compliant,[7] and some NFFEs, either because they are involved in active business or are publicly traded.[8] Other exceptions are based on FATCA IGAs.

While Congress's intent in enacting FATCA was to encourage compliance and crack down on foreign tax evasion practices consisting of underreporting or nondisclosure of foreign accounts by U.S. taxpayers, FATCA's impact reaches far beyond U.S. persons. The greatest effect is probably on FFIs because of all the logistical revamping and adjustments that they need to undertake in preparation for FATCA, but virtually every person or entity that participates in the global market is likely to be affected by the Act and thereby has the potential to become a U.S. taxpayer.

Example. John Doe, a Canadian citizen who was born, raised, and never left Abitibi-Temiscamingue, Quebec, has been offered an investment product by his local investment fund. The fund participates in another fund in Montreal, which also participates in an investment company in Toronto that invests globally, including in the United States. If the Toronto investment company, the Montreal fund, or even the Abitibi-Temiscamingue fund decides to stay an NPFFI, provided that Canada remains (as it is at the time of this writing) a non-FATCA country partner, any U.S.-source FATCA-related income (fixed and determinable annual or periodical (FDAP) income or gross receipts from the sale of property generating FDAP income) that proportionally trickles down to John Doe through this chain of investments will be subject to 30% FATCA withholding tax. This is the result even if the Toronto investment company invests in a third country's fund that invests in the United States.

Even absent FATCA, ordinary withholding under Chapter 3 of the Code would apply to the same investment product, but at a reduced tax treaty rate[9] and not to the gross proceeds of a sale of the securities generating the passthru income, which in this example, even with a loss, would still be subject to FATCA 30% withholding. The Abitibi-Temiscamingue local fund would still need to have FATCA-enhanced client on-boarding[10] and know-your-customer (KYC) due diligence controls to determine whether it has U.S. persons among its clients or prospective clients. This means that an FFI must implement these controls to determine whether it qualifies for a FATCA exemption. If it is exempt, it still must implement FATCA-enhanced monitoring systems to remain qualified for the exemption. Thus, there is no escape from FATCA, irrespective of nationality or residence, unless the financial institution is a CFFI; otherwise, FATCA is likely to make every person a potential U.S. taxpayer, every FFI an IRS auxiliary, and every FATCA country partner a U.S. foreign tax agency. Simply not dealing with U.S. persons will not get an entity off the FATCA grid if it is an FFI.

Unless the world returns to a financial ice age where financial transactions were strictly limited to the borders of a given territory, as long as a financial institution is susceptible of receiving any U.S.-source FATCA-related payment or income on a person's behalf (and not only U.S. persons), it must enter into a FATCA agreement with the IRS and comply with FATCA requirements or specific requirements determined by Treasury to make it exempt or deemed compliant. Otherwise, it exposes its clients to potential 30% withholding on FATCA-related payments even though they might be entitled to lower rates or no withholding at all.

Even if FFIs wanted to avoid FATCA by simply not doing business with U.S. persons, the universally accepted principle of nondiscrimination based on nationality or origin would oppose them because

5 Prop. Reg. 1.1471-2(b).

6 Section 1471(d)(1)(B); Prop. Regs. 1.1471-5(a)(4), 1.1471-4(c)(3)(ii)(B), and 1.1471-4(c)(4)(iv)(B)(1).

7 Section 1471(b)(2); Prop. Reg. 1.1471-1(b)(23)(i).

8 Section 1472(c); Prop. Reg. 1.1472-1(c).

9 If, instead of John Doe, the beneficial owner of the passthru payment being subject to the 30% FATCA withholding were an FFI, under Section 1474(b)(2)(A), that beneficial owner would be entitled to a refund or credit attributable to the reduced tax treaty rate. For passthru entities, there is another significant exception in Prop. Reg. 1.1471-5(a)(3)(i), which treats a trust or a partnership as the holder and owner of the financial account where they are so listed, instead of the beneficiaries of the trust or partners in the partnership.

10 This refers to the new client on-boarding policies and procedures that include, among other things U.S. indicia and other FATCA-specific verifications including U.S. substantial ownership in an NFFE as elements of the required due diligence while on-boarding new clients.

access to banking services is a basic right, and denial of these services to U.S. persons simply for being U.S. persons cannot be justified.

Possible statuses for FFIs.

Notwithstanding FATCA IGAs and deemed-compliant or excepted categories, there are only two main statuses for FFIs with respect to FATCA: (1) a CFFI, or (2) a noncompliant foreign financial institution (NCFFI).

Currently, based on the Code and Proposed Regulations, there are PFFIs,[11] NPFFIs,[12] deemed CFFIs (DCFFIs),[13] excepted FFIs (EFFIs),[14] and limited FFIs (LFFIs).[15] With the exception of NPFFIs, all categories of FFIs should be considered CFFIs because they all must meet specific and, in many instances multiple, requirements in the Act, Proposed Regulations, or otherwise specified by Treasury to be so recognized, even those operating and organized under the laws of FATCA country partners. They not only have to meet specific qualifying criteria for any of the types of CFFIs, but they also must implement FATCA-enhanced new client on-boarding controls; apply FATCA-enhanced KYC due diligence in reviewing pre-existing accounts, taking into consideration the multiple exceptions and exemptions that the IRS is still drafting; and continuously and permanently apply the same FATCA-enhanced controls to qualify and remain qualified for any of the CFFI statuses. An FFI does not need to have U.S. persons among its clients to be obliged to comply with FATCA. Before certifying that it does not have any U.S. persons among its clients, an institution must apply FATCA-enhanced controls to conduct a look-back or proactive FATCA due diligence while on-boarding new clients, and this has no expiration date.

In contrast to CFFIs, there should be a category of non-CFFIs that includes FFIs that either (1) completely ignore FATCA and its Regulations and do not attempt to identify U.S. persons while on-boarding new clients or conduct verification of preexisting accounts; or (2) fail to observe FATCA requirements while being any of the CFFIs (PFFI, DCFFI, EFFI, or LFFI) and are thereby subject to FATCA withholding.

"Non-participating FFI" is misleading because all it suggests is that the FFI does not enter into an agreement with the IRS. However, entering into an agreement with the Service does not automatically relieve an FFI from FATCA withholding, and *not* entering into an agreement with the Service does not necessarily expose an FFI to FATCA withholding. Indeed, the 30% withholding tax is the only adverse consequence of FATCA. It is no worse to be a PFFI and incur 30% withholding for not completely satisfying the requirements than to be subject to the same penalty for totally ignoring FATCA. By entering into an agreement, an FFI only commits to complying with FATCA, and by *not* entering into an agreement, an FFI does not automatically become FATCA noncompliant.

Even an "ice-age FFI,"[16] to ensure that it is not exposed to FATCA withholding at any time during its existence, must implement either FATCA-enhanced controls for on-boarding new clients or look-back verifications, or ensure that it qualifies as one of the compliant NPFFIs. It is inconceivable that today that there would be an "ice-age FFI" that would refuse to transact business with U.S. residents or citizens, including companies. FATCA is here, and if it goes into effect,[17] everyone must deal with it.

FATCA and corporate law.

Until now, despite globalization, corporate formation and restructuring have been organized and governed only according to the corporate law of the jurisdiction where a company chooses to incorporate and operate. FATCA would change this long-standing practice.

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11 An FFI with respect to which an FFI agreement with the IRS is in full force and effect. Prop. Reg. 1.1471-1(b)(23)(v).

12 An FFI other than a PFFI, deemed-compliant FFI, or an exempt beneficial owner. Prop. Reg. 1.1471-1(b)(23)(iv).

13 An FFI that is treated, pursuant to Section 1471(b)(2) and Prop. Reg. 1.1471-5(f), as meeting the requirements of Section 1471(b). Prop. Reg. 1.1471-1(b)(23)(i). This category comprises three types of FFIs—registered deemed-compliance FFIs, certified deemed-compliant FFIs, and some owner-documented FFIs. Prop. Reg. 1.1471-5(f).

14 An entity that is excluded from the definition of an FFI pursuant to Prop. Reg. 1.1471-5(e)(5) and, therefore, not subject to withholding under Section 1472. Prop. Reg. 1.1471-1(b)(18).

15 An FFI that is a member of an expanded affiliated group that includes one or more PFFIs that agree to certain conditions and, if under the laws of each jurisdiction that apply with respect to the accounts maintained by the affiliate, the latter cannot either (1) report U.S. accounts to the IRS, close them, or transfer them to an affiliate or a PFFI that can do so; or (2) with respect to recalcitrant accounts holders and accounts of NPFFIs, apply FATCA withholding, block or close them, or transfer them to the PFFI affiliate. Prop. Reg. 1.1471-4(e)(3)(ii).

16 One that restricts its operations and customer range to the strict limits of its local territory provided it can avoid all passthru foreign investments.

17 Since the United States cannot guarantee the same assistance that it is asking under FATCA IGAs, if FATCA country partners insist on getting equal assistance from the U.S., FATCA could very well be repealed because many within Congress are wondering if it will not hurt more than it helps the U.S. economy. See notes 30 and 33, *infra* (letter from four U.S. Senators to the Treasury Secretary, questioning the potential costs and benefits of FATCA from a broader economic standpoint and noting the possible withdrawal of foreign investment from the United States and foreign institutions' reluctance or refusal to do business with Americans).

Since FATCA requires not only identification of U.S. persons, but also determination of their capital ownership in non-financial foreign entities and whether it is substantial, and reporting of their personal information to the IRS, U.S. indicia and criteria of U.S. substantial business ownership should become part of routine due diligence by corporate lawyers worldwide if they do not want to expose the entity to FATCA withholding. This includes mergers and acquisitions and other corporate reorganizations. Corporate lawyers should consider receiving a waiver of privacy rights from U.S. investors so that they can report and transmit to the IRS, or their country's tax administration for a FATCA country partner, whatever information the Service might need regarding FATCA implementation. This is quite an evolution in corporate law.

License to evade taxes.

Congress's goal in enacting FATCA was and still is laudable but the impact of the vehicle used to achieve that goal is out of proportion and unwieldy, even for the IRS and Treasury, as seen by the continuous and changing guidance and exceptions that they are making to FATCA to mitigate its adverse and unpredictable consequences.[18] Treasury and the IRS realize that FATCA is simply too difficult to implement, even with the help of country partners, and are so anxious about the uncontrollable and unpredictable consequences for many businesses, including U.S entities, that they are giving license to evade foreign taxes through the very same practice that they intended to curtail. Even without analyzing the complex FATCA provisions or the soon-to-be-final Regulations to show how it is possible to empty FATCA of its substance and continue doing business as usual, the Act's weakness can be demonstrated by showing that Treasury and IRS are authorizing evasion of foreign taxes.

Section 1471(d)(1)(B) provides that unless an FFI elects not to have this subparagraph apply, U.S. accounts will not include any depository account maintained by a financial institution if (1) the account holder is a natural person, and (2) the aggregate value of all depository accounts held (in whole or in part) by that holder and maintained by the same financial institution does not exceed $50,000. This provision is supplemented by Prop. Reg. 1.1471-5(a)(4)(ii), elaborating on the aggregation requirement of this exception:[19]

> For purposes of determining whether the aggregate balance of depository accounts held by an individual exceeds $50,000 for purposes of applying the exception in this paragraph (a)(4)(i), an FFI will be required to take into account all depository accounts maintained by the FFI, or members of its expanded affiliated group, that are held (in whole or in part) by such individual, but only to the extent that the FFI's computerized systems link the accounts by reference to a data element such as client number or a taxpayer identification number (including a TIN), and allow account balances of such accounts to be aggregated. Each holder of a jointly held depository account will be attributed the entire balance of the joint account for purposes of applying the aggregation requirements described in this paragraph (a)(4)(ii).

One does not need a sophisticated tax planner to take full advantage of this exception and accumulate far higher income overseas without reporting it to the IRS. If there is a concern that the electronic system of an FFI or an expanded group of affiliated members might link several accounts held by the same individual or entity with an aggregate balance surpassing the exemption threshold, it is easy to have accounts with as many separate FFIs as possible in a single jurisdiction or in multiple jurisdictions to park hundreds of thousands or millions of dollars outside the United States free of any reporting to the IRS or taxation. FFIs will take this opportunity to avoid reporting to the Service; they could even use it as a feature to attract more U.S. persons with low deposits. This is very important to private banking because failure to guarantee anonymity to potential U.S. clients puts institutions at a significant competitive disadvantage. Why would Treasury open such a wide door to abuse that it wanted to prevent in the first place? There is no tax neutrality when those who choose to keep all their income at home incur high tax rates while others can have it tax free overseas. Although it is inconvenient to have and manage multiple bank accounts, possibly in multiple jurisdictions, compared with writing a check to the IRS, the resulting monetary advantage makes it a minor inconvenience.

IGAs Do Not Put FATCA Country Partners on Level Playing Field With the U.S.

On February 8, 2012, the same day that Treasury issued the FATCA Proposed Regulations, the United States, France, Germany, Italy,

18 Treasury retains extensive power to amend the Act through the issuance of exceptions and specific requirements.

19 Prop. Reg. 1.1471-4(c)(3)(ii)(B) provides the same exception for entities with a higher threshold of $250,000 or less.

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Spain, and the United Kingdom (G5) expressed their commitment to improving tax compliance and implementing FATCA. That joint statement materialized with the release of a model IGA on July 26, 2012.[20] In the February 8 joint statement, the G5 reaffirmed their intent to cooperate in countering offshore tax evasion and improving international tax compliance by providing a framework for reciprocal information exchange. The question is whether this model or future FATCA IGAs based on it will establish reciprocal rights and obligations between the United States and other country partners. To answer this question, it is necessary to understand what reciprocity in international law or relations really means.

Reciprocity is the basis of bilateralism in treaty law[21] and in international law or relations; it does not exist without implied equality.[22] Paraphrasing Michael Byers, reciprocity involves the idea that bilateral relationships between two "formally" equal partners are not unidirectional but necessarily suggest some element of quid pro quo.[23] Specifically "in the context of general customary international law any state claiming a right under that law has to accord all other states the same right."[24]

Reciprocity is not simply an exchange of one thing for any thing, but one right for the same right and one obligation for the same obligation. In the context of the G5 FATCA model IGA, or any other agreement, to ascertain whether FATCA country partners are on a level playing field with the United States, it must be determined what quid is in exchange for what quo.

Under the G5 FATCA model IGA, country partners of the United States agree and commit themselves to implementing FATCA's reporting regime for their financial institutions, collecting information on U.S. accounts, and reporting it to the IRS in exchange for "information regarding certain [FATCA Partner] accounts maintained by U.S. financial institutions"[25] If this apparently simple exchange is dissected, its real meaning can be understood.

First, FATCA, a U.S. law, introduces a reporting regime, and establishes specific requirements, for financial institutions of country partners. Like any law, it would not be effective without a penalty, and it provides one for the country partner's noncompliant financial institutions. The country partner commits to enforce FATCA on its territory, which means that it will compel its financial institutions to comply with all requirements under FATCA or incur the FATCA penalty. In exchange, the country partner gets information related to its residents' accounts from the U.S. government that is "maintained" by U.S. financial institutions (USFIs). It does not matter how this information is collected, when it is collected, or whether it is collected at all by USFIs.

Congress has a long-standing tradition of never taxing or requiring any reporting on deposits in U.S. banks by foreigners.[26] The House of Representatives reaffirmed this tradition on July 26, 2012, with bipartisan support of an amendment to the Red Tape Reduction Act (H.R. 4078) that delayed, among others, the Proposed Regulations (REG-146097-09, January 7, 2011)[27] that would require USFIs to report to the U.S. government interest that they pay to nonresident aliens until unemployment drops below 6% (at the time of this writing, it is 8.2%).[28] No one can predict how long it might take to get U.S. unemployment to 6%. In the meantime, it seems (and this is now confirmed by paragraph 6 of the Preamble, paragraph 1.(cc) of Article 1, and paragraph (b) of Article 2 of the U.S.-U.K. bilateral FATCA agreement, announced September

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20 www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf (joint statement) and www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf (model agreement). See "Treasury Releases FATCA Model Inter-Governmental Agreements," 23 JOIT 5 (October 2012). On the February 8 release, see note 3, *supra*. Treasury also issued joint statements on June 21, 2012, with Switzerland and Japan that provide additional information regarding the "Model II"-type intergovernmental agreement for FATCA implementation. See Read and Georgiev, " FATCA Implementation: Joint U.S. Statements with Switzerland and Japan on Intergovernmental Agreement," 23 JOIT 54 (September 2012).

21 See, among others, Byers, "Reciprocity and the Making of International Environmental Law," http://law.duke.edu/news/papers/strategyandpersuasion.pdf, page 4; Fuller, *The Morality of Law* (revised ed., Yale U. Press, 1969), pages 19-27.

22 For example, where states A and B are in a reciprocal treaty or agreement, they should have the same rights and same obligations even if A is a small island and B a superpower.

23 See Byers, *supra* note 21, page 4.

24 *Id.*

25 See model agreement, *supra* note 20.

26 See Center for Freedom and Prosperity, "CF&P President: Congressional Vote on IRS Regulation Is First Step in Reasserting Proper Legislative Role in Policymaking," July 31, 2012, http://freedomandprosperity.org/2012/press-releases/congressional-vote-irs-regulation-first-step; Mitchell, "Who Writes the Law: Congress or IRS?," Prosperitas, Vol. III, Issue I, Center for Freedom and Prosperity, February 15, 2003, http://freedomandprosperity.org/2003/publications/who-writes-the-law-congress-or-the-irs/.

27 See Spencer, New U.S. Regs. on Reporting Nonresident Alien Bank Deposit Interest," 22 JOIT 30 (June 2011).

28 See also Matthews, "House Votes to Postpone IRS Rule on Foreign Deposits in U.S. Banks," Orlando Sentinel, July 26, 2012, http://articles.orlandosentinel.com/2012-07-26/news/os-congress-bank-vote-20120726_1_irs-rule-offshore-tax-evasion-foreign-deposits.

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14, 2012)[29] that, despite the House rejection of REG-146097-09, the U.S. Treasury Secretary intends to use his regulatory power under FATCA and implement anyway measures under REG-146097-09 from January 1, 2013, since H.R. 4078 is stalled in the U.S. Senate. While this is very encouraging, as it shows U.S. determination to help its partners in their fight against tax evasion by their residents, it still falls short of representing equal or identical reciprocity with respect to FATCA. Not only is this commitment by the United States not supported by Congress, because the Senate could still pass H.R. 4078,[30] which in substance will kill REG-146097-09, but also in this situation, the United States is neither implementing nor enforcing the U.K. FATCA-like law that U.K. Parliament is currently discussing, and USFIs are not subject to any FATCA-like penalty in the case of noncompliance or any FATCA-like "recalcitrant account holder" regime in the case of a U.K. resident's refusal to cooperate. The country partner is sovereign, with a Parliament that legislates and an administration that enforces, but apart from not converting FATCA into domestic law, the partner also has no similar foreign reporting regime to which USFIs are subject and that requires the U.S. government to enforce in the United States. The only instrument that the partner can rely on is the fragile REG-146097-09, which as noted is under threat of being blocked by Congress. FATCA extraterritorial enforcement by a FATCA country partner within its borders makes the country a U.S. foreign tax agency. Why are these countries not putting USFIs in the same position as financial institutions in their own country and the rest of the world with respect to foreign tax reporting? Is it because they do not have the power to resist the United States or is it simply that they do not see that FATCA will turn the world into a U.S. "financial colony"? The only way for FATCA country partners to level the playing field with the United States is to enact their own FATCA-like laws with a penalty for noncompliance by USFIs similar to 30% withholding under FATCA. This will create identical reciprocal rights and obligations that will guarantee compliance by USFIs with other countries' similar laws.

Although it is not yet completely clear how FATCA will affect investors internationally, because it very much depends on the FFI's status once FATCA kicks in, the agitation that FATCA is already causing worldwide will have a serious impact on investment activities and capital movement in general. Despite the agreement by many countries to cooperate with the United States, FATCA is clearly not welcome in the financial world. With just a few months left before FATCA is officially effective, it is probably too late to consider what could or should be done to stop it. There is something that FFIs can do, however, especially those in countries that have already agreed to implement FATCA. They can lobby their governments to defend them from this invasive foreign tax law instead of accommodating it. As noted previously, absent equal or identical reciprocity, all that a FATCA IGA does is create a legal base for the implementation of Chapter 4 of the U.S. Internal Revenue Code extraterritorially, making it an "international Act," which turns FATCA country partners into U.S. foreign tax agencies and every investor in the world into a potential U.S. taxpayer, thereby welcoming the world's first financial colonization.

Considering the distress that FFIs are experiencing from being compelled to apply measures to identify and report on U.S. accounts, how would USFIs react to being put in the same situation with respect to foreign accounts pursuant to foreign laws? FFIs must comply only with FATCA, while USFIs would be required to comply with as many FATCA-like laws as there are FATCA country partners until common global standards are put in place. The United States probably has the highest concentration of foreigners in the world. While this does not mean much for FATCA country partners, because none apply citizenship-based taxation, it nonetheless provides temporary residents with a big opportunity to invest in USFIs. This means, among other things, that the increase in compliance costs that FFIs face due to the restructuring of their client on-boarding and KYC due diligence controls to make them FATCA compliant and to report clients' information will be multiplied by the dozens for USFIs.[31] This will undoubtedly stretch their account management capabilities, especially with respect to foreign-source income, and cause them such operational

29 The U.S.-U.K. agreement will be covered in the December 2012 issue of the Journal.

30 Questioning U.S. reciprocal obligations toward the FATCA G5 countries, four U.S. Senators asked Treasury to provide the legal basis for USFIs collecting information on residents of FATCA G-5 countries and reporting it to the IRS or tell them if Treasury intends to request from Congress a legislative action for this purpose and when it intends to do so. See July 25, 2012, letter to Treasury Secretary Geithner from Senators Paul (R-KY), DeMint (R-SC), Lee (R-UT), and Chambliss (R-GA), www.repealfatca.com/downloads/letter.pdf.

31 See letter, *supra* note 30, where the Senators raised this issue among others that they want the Treasury Secretary to answer regarding U.S. commitment to FATCA reciprocity. Re-

and financial difficulties that they will vigorously lobby the U.S. government for repeal of this globalization killer Act.

As noted, at the time of this writing, Canada, the G-7 country closest to the United States, and economically probably the most dependent on the U.S. market, has not yet joined the FATCA country partners. Given the number of U.S. citizens living in Canada, having dual Canadian citizenship, or simply having close ties, and the number of Canadians having similar connections, the amount of investment that Canadians have in the United States is naturally very high. Because of this, Canadians investing in the United States rely considerably on U.S.-sourced FDAP income and gross receipts from sales of various U.S. properties, including securities as the main source of their investment income. The Canadian government, therefore, must not make a wrong move with respect to FATCA. Indeed, Canada is the country most exposed to FATCA's negative effects because of its strong economic and financial ties with the U.S.

One thing that is certain is that with the same goals, including possible assistance in tax collection, FATCA could violate the very convention[32] that should normally constitute the legal basis for a U.S.-Canada agreement for the implementation of FATCA in Canada, but also, in its current form, aggressively providing for an extraterritorial regime, FATCA can be denied implementation or enforcement in Canada. This is not simply due to possible clashes with the Canadian privacy laws but because of Canada's Foreign Extraterritorial Measures Act (R.S.C., 1985, c. F-29), specifically conceived and enacted to deny effect to extraterritorial Acts of foreign governments violating Canadian sovereignty.

In this regard, there is a precedent in which an Order under the authority of this Canadian Act was taken specifically against section 1706(a)(1) of the National Defense Authorization Act for Fiscal Year 1993, as passed by the U.S. Congress on October 5, 1992, which affects section 515.559 of Title 31, Part 515, of the U.S. Code of Federal Regulations ("Cuban Assets Control Regulations," July 8, 1963). The Foreign Extraterritorial Measures Act (United States) Order of October 9, 1992 (SOR-92-584) was issued by the Canadian Attorney General jointly with the Secretary of State for External Affairs to prohibit a Canadian corporation, or director, officer, manager, or employee in a position of authority of a Canadian corporation, from complying with this U.S. law. Since FATCA is even more aggressive in the sense that it not only provides for a regime specifically designed for FFIs but also obliges them and in some cases requires foreign tax administrations to perform administrative duties on behalf of the IRS, it is certain that SOR-92-584 will always be invoked as a precedent against any attempt to implement or enforce FATCA in Canada. Many other countries including Australia, the U.K., the Netherlands, Sweden, Japan, and France[33] have similar laws that could be relied on to block implementation of U.S. Internal Revenue Code Chapter 4 in their respective countries. Although in many cases, like French Law No 80-538 of July 1980,[34] these blocking statutes are subject to international agreement, if it can be proved in court that the agreement is per se unconstitutional because it obviously infringes the country's sovereignty where it compels the local administration to implement and enforce a foreign public law without equal reciprocity, FATCA could be invalidated in many countries notwithstanding FATCA IGAs. It may be easier to fight extraterritorial implementation

lying on two studies on the cost for FFIs to comply with FATCA, the Senators asked the Secretary to provide them with a study assessing on an aggregate and per institution basis the highest and lowest estimates of the probable cost for USFIs and non-financial U.S. entities (NFUEs) to collect information and report on residents of France, Germany, Italy, Spain, and the United Kingdom.

32 Article XXVIA(8) of the 1980 U.S.-Canada income tax treaty provides that the U.S. cannot collect tax from a Canadian citizen in Canada and Canada cannot collect tax from a U.S. citizen in the U.S. Responding to a letter from a Canadian citizen regarding Canada's November 2011 signing at the G-20 Summit in Cannes of the OECD Convention on Mutual Administrative Assistance in Tax Matters, including section II related to assist in tax recovery (Articles 11 through 16), Canadian Finance Minister Jim Flaherty, in a letter dated February 10, 2012, wrote: ". . .It is intended that, at the time of the deposit of Canada's instrument of ratification of the Convention with the Secretary General of the OECD, Canada will reserve against Article 11 to 16 of the Convention and consequently, will not be bound by the Convention's provisions in respect of the assistance in the recovery of tax claims...." http://isaacbrocksociety.ca/2012/02/13/3200.

33 See Gottridge and Rouhette, "France Puts Some Muscle Behind Its Blocking Statute," 239 New York Law Journal No. 82 (April 29, 2008).

34 Article 1 and Article 1-bis of Loi No 80-538 of July 16, 1980, Journal Officiel de la RØpublique Franaise, July 17, 1980, page 1799. According to Gibson Dunn, one reason for the reference to international agreements in this Article was to excluding from the law's prohibition inquiries pursuant to the March 18, 1970, Hague Convention, which constitutes the international basis for the taking of evidence abroad in civil and commercial proceedings. See Dunn, "The French Supreme Court Applies the 1980 Blocking Statute for the First Time and Strengthens the Conditions Under Which Evidence to Be Used in Foreign Litigation Can Be Obtained in France," January 17, 2008, www.gibsondunn.com/publications/pages/frenchsupremecourtapplies1980blockingstatute.aspx.

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and enforcement of FATCA in courts because governments are abandoning their primary responsibility of defending their sovereignty and protecting the interest of their citizens in the face of an invasive foreign tax law. Until they actually take the government to court, residents and companies of foreign countries affected by FATCA can never know if they can be protected against it.

Conclusion

The United States does not have the right to enact "international Acts," and no country, even on grounds of a "long history of cooperation," should agree to surrender any parcel of its sovereignty without reciprocity. Tax evasion, in whatever form and by whatever means, should be deterred, discouraged, prevented, and stopped. However, when the fight involves extraterritorial factors, the universally accepted and only civilized international tax order demands that it be achieved through negotiated bilateral or multilateral treaty mechanisms based on equal and identical reciprocity.

An FFI does not need to have U.S. persons among its clients to be obliged to comply with FATCA

It is no worse to be a PFFI and incur 30% withholding for not completely satisfying the requirements than to be subject to the same penalty for totally ignoring FATCA

Canada is the country most exposed to FATCA's negative effects because of its strong economic and financial ties with the U.S.