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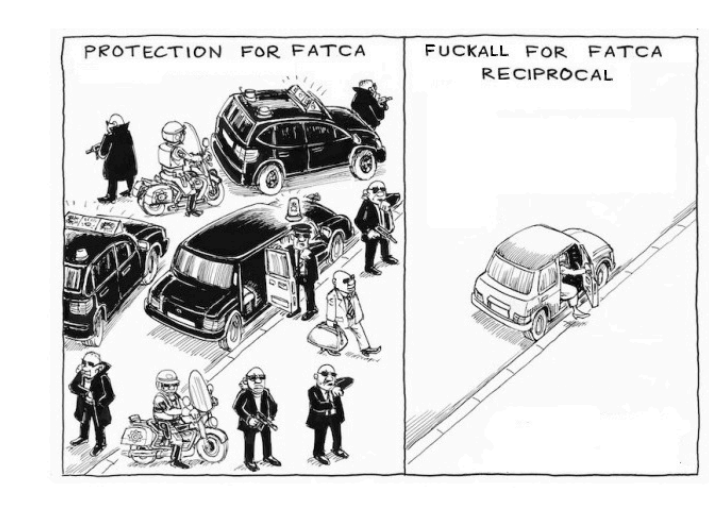

If a Democrat Congress ever approved FATCA equivalent reciprocal reporting, it will be worthless due to so many loopholes...

Mark Morris
CRS and CARF expert. No, truly.

September 5, 2024

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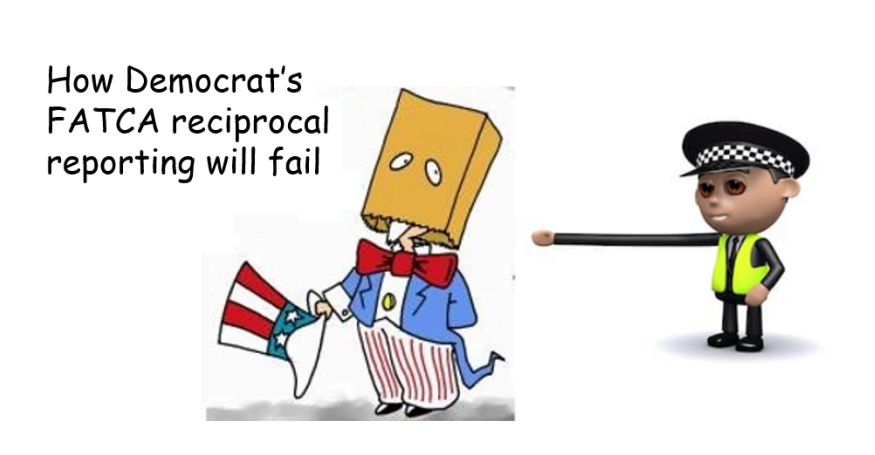
FATCA full equivalent reciprocal reporting will be totally useless which OECD has closed in CRS


How Democrat's FATCA reciprocal reporting will fail

- Happily or sadly, depending on your view, the USA will continue being the jurisdiction of choice for the rest of the world's tax-dodgers to hide their money from their taxman, Pasquantino be damned. The Democrat's promised equivalent Foreign Account Tax Compliance Act ("FATCA") reciprocal reporting rules has so many loopholes, that it ain't worth spit.
- Assuming Biden wins the Presidency and Democrats control both houses of Congress, the IGA promised FATCA equivalent reciprocal reporting will be enacted. Currently, it applies only to deposit interest for non-resident aliens resident in a handful of countries.
- The hundreds of thousands of tax-dodgers who went to the effort of shifting their bank accounts or trusts or policies to the USA to avoid the Common Reporting Standard ("CRS") will have no qualms whatsoever to exploit FATCA's reciprocal loopholes.
- Don't hold your breath that IRS or US Financial Institutions will discourage or contest these loopholes.

Democrats will surely legislate FATCA equivalent reporting but to no avail.

ReactionGIF.org

- While negotiating the FATCA intergovernmental agreement with third-party countries to sign up to FATCA, Treasury was forced to give its word that it would one day commit to equivalent reciprocal reporting. Laughably, this promise was excepted by negotiating partners.
- Lo and behold, the Republican-controlled Congress stymied the pledged reciprocity. Obama's administration thrice urged the Republican-led Congress to enact proposals to provide "full reciprocity under FATCA", so as to ensure that the United States can live up to its end of the bargain on foreign tax reporting.
- Posey, a Republican Representative was tasked to tell Obama's administration to get lost cynically replied to Obama's Treasury secretary that despite US requesting other nations to report on US persons, USA reciprocal reporting would discourage investment in the USA, would impose costly compliance costs.

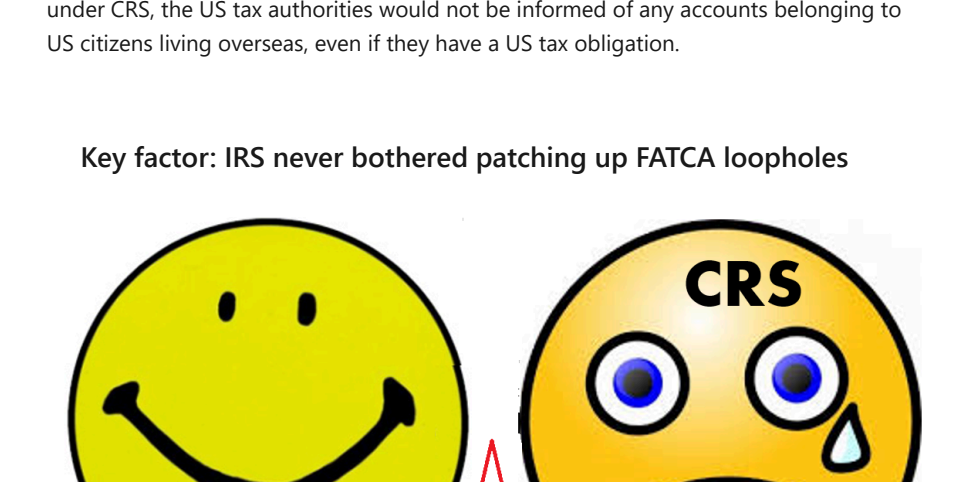
Were the FATCA IGAs legal as they was never legislated

- FATCA IGA was merely an Obama executive order. Republicans opine that the IGA reciprocity promise is not valid because it was not under the advice and consent of the Senate, and is an illicit Democrat presidential executive order. Constitutional law professor article on why FATCA Intergovernmental Agreements Bind the U.S. Government. For the argument that the legality of IGA is far from certain see The Dubious Legal Pedigree of IGAs and why it matters. Trump did not overturn Obama's IGA executive order because it is unlikely any lawmaker would want to veto automatic collection of information on US tax-dodgers. When the Democrats return to power with the Presidency and both houses of Congress, it is assured the promised FATCA IGA full reciprocity will be legislated. However, due to FATCAs loopholes, this will be a useless exercise.

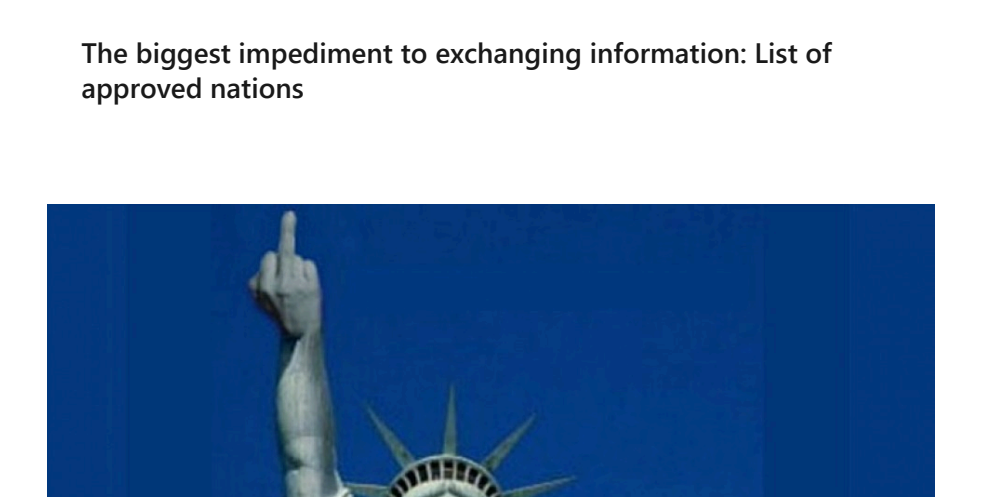
US will not replace FATCA with CRS

- As many countries adopted the CRS, there has been pressure from around the world for the US to follow suit. According to a General Accounting Office report from Congress, the US is unlikely to abandon its FATCA.
- Although CRS was based on US legislation, it focuses on tax-residence rather than citizenship. The congressional report argues that swapping FATCA for CRS would cost the US an unknown amount to make the changes without any tangible benefit to the IRS. In fact, under CRS, the US tax authorities would not be informed of any accounts belonging to US citizens living overseas, even if they have a US tax obligation.
- However, under CRS rules, the financial institution would only need to share information with the jurisdiction of tax residency, instead of the IRS as FATCA requires. The congressional report argues that swapping FATCA for CRS would cost the US an 'unknown amount' to make the changes without any tangible benefit to the IRS. In fact, under CRS, the US tax authorities would not be informed of any accounts belonging to US citizens living overseas, even if they have a US tax obligation.

Key factor: IRS never bothered patching up FATCA loopholes


FATCA
CRS
Loophole gap you can drive a truck through

The biggest impediment to exchanging information: List of approved nations



- The biggest impediment to automatic exchange of information is that the US maintains a list of countries that the US deems satisfactory to provide information.
- US has tax agreements with 94 countries but only categorise 51 as being safe ⬅️ ⬅️ to provide AEoI

- The USA will only **consider** FATCA's reciprocal automatic exchange of information with countries that have a tax agreement with US
- A subset of these 94 countries with which the US has an income tax or other convention or bilateral agreement relating to the exchange of tax information are potential candidates for AEOI from the USA a
- This subset (now at 51 countries) is listed in the countries which US provides the limited reciprocal FATCA information, i.e. interest on bank deposits paid to nonresident aliens.

Rev Proc 2023-36 page 1485 Rules and Regulations on USA AEOI

Safe trusted countries that can request BOI from CTA

> Australia, Argentina, Azerbaijan, Belgium, Brazil, Canada, Colombia, Croatia, Curaçao, Cyprus, Czech, Denmark, Dominican Republic, Estonia, Finland, France, Germany, Gibraltar, Greece, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Israel, Italy, Jamaica, Jersey, Kazakhstan, Republic of Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Netherlands, New Zealand, Norway, Panama, Poland, Portugal, Saint Lucia, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Turkey, United Kingdom. Note Switzerland is not on list as it was an IGA-2 country, which was non reciprocal when teh list was published.

- For example, countries not on the list such as Chinese, Peru or Japan residents can carry on hiding money in the USA until the cows come home.

Dirty dozen ways FATCA equivalent reciprocity will be avoided

US Senate Finance Committee 2022 investigates a multi-billion "shell bank"cheat of FATCA reporting on assets held by Swiss banks. NOTE: The correct term for "shell bank" is "managed Investment Entity"

The 2022 US Senate Finance Committee investigation and summary report of billionaire Robert Brockman's use of a Managed Investment Entity to cheat on FATCA. This so-called "loophole" is unsophisticated for knuckle-dragging simians.

Click on the picture to read the Senate Investigation report

How the shell bank (actually the managed Investment Entity) loophole so-called worked

- Offshore financial institutions registered with the IRS are required by law to identify and report certain information about U.S. accounts. To implement these requirements, the United States entered into intergovernmental agreements with foreign partner jurisdictions to establish reporting requirements on U.S. accounts, including whether and to what extent financial institutions must make efforts to determine if an account is held by a U.S. person. Federal statute, regulations, and FATCA agreements with partner jurisdictions provide that when the account holder is believed to be a non-U.S. financial institution in a partner jurisdiction with an IRS-issued Global Intermediary Identification Number (GIIN), "no further review, identification, or reporting is required concerning the account."
- Due to this carve-out, as long as a non-US bank can identify an entity's GIIN number on an IRS-published list of registered foreign financial institutions, it is not required by FATCA to affirmatively investigate whether the account is held by a U.S. person. The financial institutions (managed Investment Entities) holding accounts at foreign banks, can self-certify that they do not hold any U.S. account.
- The Managed Investment Entity straight-out lied and falsely certified there was no US person account holder.

- **No reporting by Investment Entity if it is considered located in the same jurisdiction as its account holder** - For example here, the US bank will not report on its Investment Entity account holder, or report 'no reportable persons'.
- The untaxed Investment Entity will not report on its account holder which is resident in the same jurisdiction as the reporting Investment Entity The jurisdiction that is responsible to enforce reporting by an untaxed Investment Entity is described in my other articles. The loophole is based on the principle that an untaxed Investment entity such as a trust is subject to the jurisdiction where the trustee is resident.
- So, where a trust has its account with US bank and the trustee is a French resident and the settlor & beneficiaries are French-residents.
- The US bank won't report on the trust as it's an FI. The trust won't report on its equity interest, settlor and beneficiaries, because the FI and the account holders are all located in France.

- **FATCA does not treat non-participating Investment Entities as Passive NFEs** - FATCA has no concept of non-participating jurisdictions. Certainly, FATCA won't give two hoots if the Investment Entity is located in a CRS participating jurisdiction or not.
- So, if an Investment Entity is considered located in a non-CRS participating jurisdiction, there will be no reporting by the US FI maintaining the assets of the Investment Entity, nor will there be reporting by the non-CRS participating Investment Entity.
- There is no look through of a non-CRS Investment Entity. For example a Dutch trust with a North Macedonian trustee and bank account in the USA.
- Don't snigger, there are EU / EEA tax-autonomous regions excluded from CRS and FATCA, or regions where CRS breaks down such as Northern Cyprus.

> CRS jurisdiction Investment Entity with US bank account: Where it gets interesting is if the Investment Entity in question is located in a CRS jurisdiction. FATCA reciprocal reporting may require the Investment Entity to obtain a GIIN. There is no equivalent CRS identification number. If the CRS located Investment Entity has a US bank account, will the CRS jurisdiction be able to enforce reporting once the Investment Entity registers for a GIIN? Despite OECD recommending a cross check of GIIN registrations which have not registered as a CRS Flery few CRS jurisdictions track FIs registered with a GIIN which do not register as a CRS FI, I believe Singapore is the only territory that ha spublically mentioned such future anti-avoidance strategy. This is a weakness, but not a loophole. The strong loophole remains where the Investment Entity is structured to be considered located in a non-CRS jurisdiction.

US territories - every FATCA intergovernmental agreement, without exception (see definition of the USA for the agreement), explicitly exempts the five US inhabited territories from the definition of USA. Financial Institutions in Puerto Rico will mint it by promoting themselves as FATCA and CRS exempt.

- **Broad participation retirement plans** - The OECD closed the loophole concerning segregated pensions, i.e. where each member has their own compartmentalised portfolio within one master fund, does not qualify as a non-reporting FI. In contrast, US segregated pensions will be exploited as non-reporting FIs.

- **Cash in Active NFE** - The OECD closed the ambiguity that an entity earning business or trading income with substantial cash is a reportable Passive NFE, whereas US banks would blissfully incorrectly regard these business entities as Active NFEs and not report on their controlling persons.

- **Settlors irrevocable trusts report zero** - USA will likely follow Singapore's example of reporting a null value for settlors of Investment Entity trusts.

Zero cash value PPLI - The OECD CRS FAQ clarified that irrevocable insurance is a cash value policy and the reportable account holder is the policyholder. However, FATCA has not corrected this loophole and would regard a zero cash value policy as being out of the scope of FATCA.

- **Trust as an Active NFE holding entity** - Trusts holding operational companies should never have been allowed categorisation as Active NFEs. The term "Investment Entity" does not include an Entity that is an Active NFE where substantially all of the activities of the NFE consist of holding subsidiaries that engage in trade or business. What I do blame the naive IRS to allow trusts to qualify as Active NFE if it holds companies that engage in business. Trusts have completely different purposes of holding companies. Trusts collect income from financial investments in operating companies and distribute profits to settlor/beneficiaries. Why on earth then are these types trusts allowed to qualify their entity categorisation as Active NFEs?

Listed entities - An entity listed on a small stock exchange such as Curacao but not traded, maintains its bank account in the US. It's a Passive NFE but US banks need not identify controlling persons of listed entities.

- **Exploiting exemption of related to regularly traded** - Give credit, where credit is due. Creative planners are exploiting the exempted definition of related entity of an Active NFE type B to hold non-reportable investment portfolios. Active NFE type B...

> (b) The stock of the NFE is regularly traded on an established securities market or the NFE is a Related Entity of an Entity the stock of which is regularly traded on an established securities market.

> What if you're related to a related entity? That's where the loophole resides. Let's look at a subsidiary which is an NFE whose stock is regularly traded on an established securities market. Note that this could be some listing on an obscure alternative exchange such as Malta's alternative company listing, Hong Kong growth enterprise market, DSCX in Curacao, TISE in Channel islands, AIM and NEX in UK, APX in Australia, AltX in South Africa, the list goes on.... Now, what if a sister company of the listed entity is a private investment company holding a portfolio worth many times than the listed entity holdings? Is this sister portfolio company a related entity of the listed entity and hence itself an Active NFE? That wouldn't make much sense. Aha, fortunately for the tax evader, the sister portfolio company according to the CRS is indeed related to the listed entity. Alice through the looking glass madness here. Let's peel back the layers or in this case one layer, on what "related" means. CRS page 62:

> An Entity is a "Related Entity" of another Entity if either Entity controls the other Entity, or the two Entities are under common control. For this purpose control includes direct or indirect ownership of more than 50% of the vote and value in an Entity.

- Tax evading client sets up a holding company **A** which buys 50% of company **B**, a regularly traded entity on a secondary exchange. This can cost as little as a villa. Company **A** also sets up subsidiary **C** which has a huge investment portfolio with a private bank. Company **A** controls both its subsidiaries **B** and **C** through voting rights. Now get this, although company **C** has absolutely nothing to do with listed entity **B**, it is a related entity of **B** because it's under common control of **A**. How ludicrous, ridiculous, crazy, abusive is that? C'est la vie, portfolio company **C** is legally exempt from the CRS reporting because it's related to a regularly traded entity. I suppose that the OECD envisaged related entities of listed entities were solely the parent or subsidiary when granting Active NFE status. No way did they consider a sister of a regularly traded entity. The term '***related***' in the case of Active FE type B regularly traded entity should only refer to a parent or subsidiaries. Related should certainly not include "under common management".

More FATCA loopholes

There are at least a dozen more FATCA loopholes.

You can troll through my linkedin articles to review them.

Summary

- The purpose of this article is that FATCA equivalent reciprocal reporting is a useless exercise designed to appease the third-party countries, but tax-dodgers will be able to continue hiding their undeclared stash in the USA **until the cows come home**. No mandatory disclosure rules against arrangements to avoid FATCA. OECD has implemented BEPS style anti-avoidance for mandatory disclosure rules for arrangements to avoid CRS. There is no way the US will pursue non-US persons who utilise arrangements to avoid FATCA. In any event, it will be onerous for the US to determine where a trustee of a US trust resides is for avoiding reciprocity reporting.

=============================END============================

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