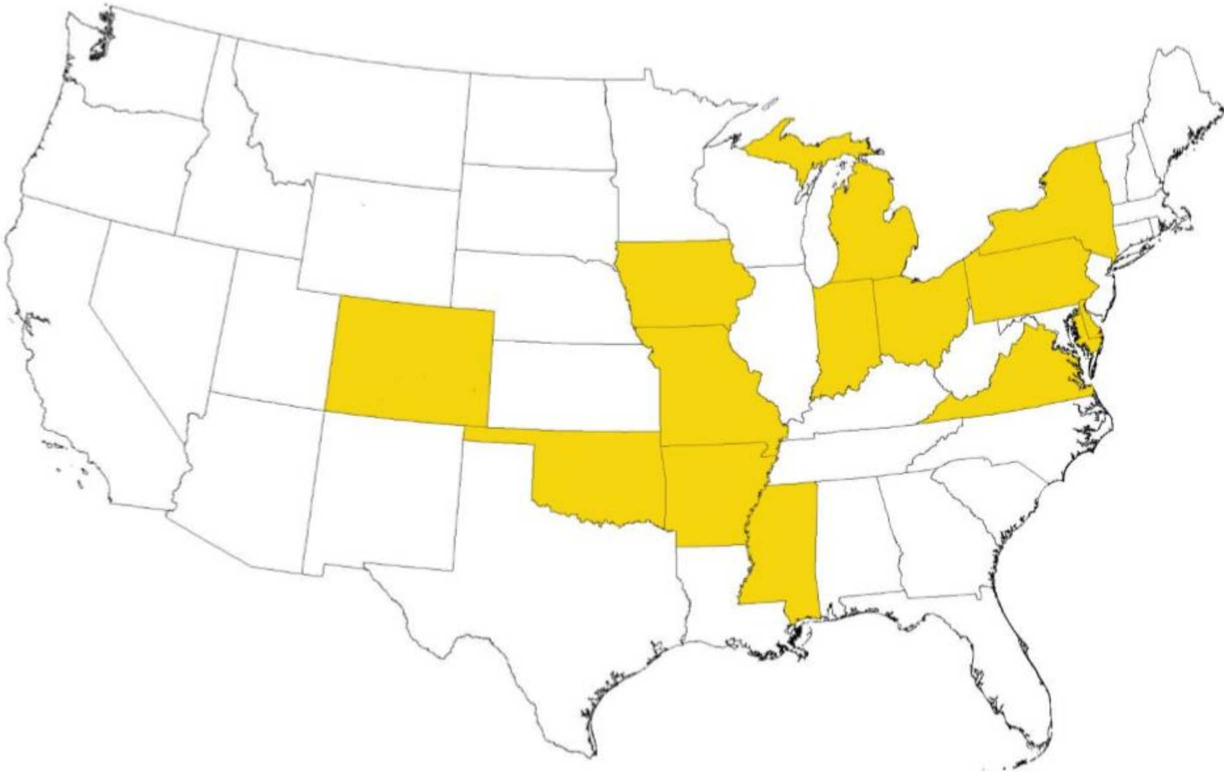
THE ROLE OF THE U.S. AS A TAX HAVEN

IMPLICATIONS FOR EUROPE



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EXECUTIVE SUMMARY

Two global transparency initiatives are underway that could help tackle financial crimes including tax evasion, money laundering and corruption: registration of beneficial ownership for companies (to identify the real persons owning or controlling such companies) and automatic exchange of bank account information between tax administrations. The European Union has made progress in both respects, with the adoption of a 4th anti-money laundering Directive (in May 2015) and by committing to implement the OECD's common reporting standard for automatic exchange of financial account information. The United States (U.S.), in contrast, has done neither so far.

On May 5th, 2016 the U.S. announced new measures to improve its financial transparency, although not all the texts of the proposed regulations were provided. The U.S. Treasury announced three new measures:

- A Customer Due Diligence Final Rule, adding new requirements on financial institutions – to collect and verify beneficial owners information;
- A legislative proposal on Beneficial Ownership that would require companies to know and report adequate and accurate beneficial ownership information at the time of a company's creation legislation. This proposal will need Congress' approval.
- And proposed regulations related to foreign-owned, single-member limited liability companies (LLCs) to obtain an employer identification number with the U.S. tax authorities. This proposal is open for comments for 90 days.

In any case, not only would some of these new rules require Congress approval, but even the U.S. Treasury final proposals on beneficial ownership collection by financial institutions are not enough to solve all the problems nor to bring the U.S. into line with the OECD's standard for automatic exchange of information.

The U.S. is a major financial centre. It holds almost 20% of the global market share of financial services for non-residents, foreign assets amounted to USD 16,745 Billion in 2013, and foreign direct investment reached USD 2.900 Billion in 2014. However, its transparency legal framework is not consistent with the responsibility involved in being a major financial hub. An investigation in 2012 found that "obtaining an anonymous shell company is therefore easier in the U.S. than in the rest of the world". Worryingly, it also noted that "Wyoming, Delaware and Nevada were among the worst in being the most likely to supply untraceable shell companies […] to foreign clients". This was confirmed by the U.S. Treasury Secretary in his letter to the U.S. Congress of May 5th, 2016: "gaps remain in our laws that allow bad actors to deliberately use U.S. companies to hide money laundering, tax evasion, and other illicit financial activities".

Two main issues in the U.S. affect the global progress towards transparency:

AVAILABILITY OF ANONYMOUS COMPANIES

Company registration is regulated by each of the 50 states' law. **In 14 states, companies may be created identifying neither shareholders nor managers**. At the federal level, tax rules require filing some information to obtain an Employer Identification Number (EIN). However, **not all companies require an EIN** and, even if they do, **the 'beneficial owners'** (the actual natural persons owning or controlling the company) **are not necessarily among the information to be provided.** Companies only have to identify one 'responsible party', who may be a

nominee director. In order to (partially) address this, the White House 2017 budget proposal and the new measures proposed on May 5th, 2016 suggest requiring all companies (or according to the May 5th proposed rules, at least some foreign-owned disregarded entities, such as single-member limited liability companies) to obtain an EIN. Not only does this proposal need to become effective, but information would apparently still be about the 'responsible party' and not necessarily about the real physical person owning and controlling the company (the so-called beneficial owner).

NEITHER GLOBAL NOR RECIPROCAL AUTOMATIC EXCHANGE OF BANK ACCOUNT INFORMATION

The U.S. has refused to join the trend for multilateral automatic exchange of information. Instead, it will implement its domestic law called the Foreign Account Tax Compliance Act (FATCA) and the related Inter-Governmental Agreements signed with other countries. However, these involve unequal exchanges of information: the U.S. receives more information than what it sends (for example, about beneficial ownership data). Oddly, though, the OECD did not include the U.S. among jurisdictions that did not commit to its new standard.

Even if the U.S. committed to exchange equal levels of information in the future, **the current U.S. legal framework does not allow its financial institutions to collect beneficial ownership information for all relevant cases** covered by the OECD's global automatic exchange of information standard. U.S. financial institutions are currently only required to obtain information on beneficial owners for correspondent banking (i.e. accounts held for foreign financial institutions) and for private banking of non-U.S. clients (accounts holding more than USD 1 million).

Final rules to address these limitations have been announced on May 5th, 2016 although financial institutions must comply with them only by May 11th, 2018. However, the final rules still have the same problems that the IMF identified regarding the 2014 version of the rules so they will not fix all the problems. Remaining shortcomings include: some entities will still not be covered (i.e. insurance companies), the definition of 'beneficial owner' is incomplete (it does not include the 'control through other means' test, meaning that if you cannot identify at least one person owning 25% or more of the shares, financial institutions should try to find someone who controls the company through other means, before identifying only someone with a managerial position - who may be a nominee director), the verification of information would rely mainly on customer's own certification, information on beneficial owners would be required for new accounts only (not for existing ones) and it will not need to be updated after the first time of collection, unless the financial institution becomes aware of changes as part of monitoring for risks. In addition, trusts will not be required to provide beneficial ownership information unless they own enough equity in an entity, such as a company, required to provide this information.

To fix this situation and promote equal levels of transparency, this paper provides a series of recommendations. For example, the European Union should consider including the U.S. in the upcoming list of tax havens, unless it effectively ensures registration of beneficial ownership information for companies and commits to equal levels of automatic exchange of information with European Union countries. Ideally, all financial centres should effectively implement the OECD standard for automatic exchange of information (by becoming a party to the OECD Amended Multilateral Tax Convention, signing the Multilateral Competent Authority Agreement and agreeing to exchange information with all other cosignatories). The European Union could thus consider imposing a sanction (such as a 30% withholding tax on all EU-sourced payments) against any financial institution that refuses to automatically exchange information about EU residents holding accounts abroad. In a second stage, sanctions could also be used to ensure that financial institutions from financial centres will also provide information to developing countries with which the European Union is already exchanging information.

INTRODUCTION

THE IMPORTANCE OF THE NEW GLOBAL STANDARD ON AUTOMATIC EXCHANGE OF INFORMATION

Tax havens enable financial crimes (money laundering, finance of terrorism, hiding proceeds of corruption, evading taxes, market rigging, etc.) by offering secrecy to individuals and companies. This opacity may be offered to keep ownership of assets secret (i.e. a banking secrecy) or to keep the identity of individuals secret, by allowing them to hide behind layers of companies, trusts, etc. The latter assures that even if authorities find out which company or trust holds a bank account or a house as the immediate (or "legal") owner, the real individual hiding behind such entity (called the "beneficial owner" or BO) will not be identified.

Since tax authorities of country A have no power to go to country B to ask a bank for information, they need an international agreement with country B to request such data. **Up until 2014 the main global standard to exchange information among tax authorities was upon request**. Fishing expeditions (asking another jurisdiction to hand over information about all residents holding a bank account there) were strictly prohibited. Requests had to identify a specific taxpayer and provide evidence as to why information was sought. In other words, requests usually confirmed information already known but did not provide fresh leads to new cases (about unknown offenders).

Automatic exchange of information (AEOI) has the potential to change this. In September 2013, the G20 Leaders endorsed the proposal for a truly global model of automatic exchange and invited the OECD to present such a new single standard. In February 2014, the G20 Finance Ministers endorsed the OECD proposal for a **Common Reporting Standard (CRS), making global automatic exchange of tax information the upcoming reality.** Countries implementing the OECD's CRS will annually exchange information with each other about all of their residents. This will only cover financial account information (i.e. bank account information, data on income from mutual funds and from some insurance companies), but not ownership of fix assets such as houses, yachts, gold or art. On the bright side, however, hiding behind layers of entities such as shell companies and trusts should not award much protection anymore. In certain cases (when the account holder is an entity whose income is mostly passive, such as from interests, dividends, etc.) the beneficial owners will also be identified and reported to their jurisdiction of residence.

Once AEOI pursuant to the CRS becomes effective in 2017 or 2018, participating jurisdictions will receive troves of valuable data, which may lead to future requests of specific information to obtain more details. **The U.S. however, has decided not to participate in the CRS**.

1. THE UNITED STATES: A MAJOR TAX HAVEN

In 2015, the U.S. was ranked the 3rd top jurisdiction of the Tax Justice Network's Financial Secrecy Index[1] which analyses the legal framework of jurisdictions in terms of banking secrecy, ownership registration of companies, trusts, foundations and partnerships, compliance with international anti-money laundering recommendations, etc. While other jurisdictions are arguably more secretive than the U.S., the Financial Secrecy Index considers also the size of every jurisdiction's financial centre. After all, an extremely opaque country would hardly have any global impact if no one uses it to hide assets or incorporate companies. In contrast, even relatively minor secrecy loopholes may have huge global consequences when dealing with the world's largest financial centre used by individuals from all countries. According to the Index, the U.S. holds almost 20%[2] of the global market share of financial services for non-residents. Foreign assets in the U.S. amounted to USD 16,745 Billion[3] in 2013, almost double than the United Kingdom (second highest). In 2014 foreign direct investment in the U.S. reached USD 2.900 Billion[4] with almost 60% coming from the EU (USD 325 Billion of these EU-originating investments corresponded to depositary institutions, finance and insurance).

The role of the U.S. as a major tax haven has already been highlighted[5] because it offers secrecy and because it will not exchange as much tax information with other countries, attracting thus much of the money located in many traditional tax havens (which are now committing to new global transparency initiatives).

A. ANONYMOUS COMPANIES IN THE U.S: NO NEED TO IDENTIFY BENEFICIAL OWNERS

A reported secrecy risk in the U.S. is related to companies[6]**, especially limited liability companies (LLCs) which may be created in most U.S. states without providing ownership information.** Tax laws at the federal level are not enough to offset this secrecy. This view was confirmed by the OECD's 2013 Global Forum Peer Review on the U.S.[7] which assesses the legal framework of jurisdictions in terms of availability and access to data for exchanges of information purposes.

In 2006 the Financial Action Task Force (FATF), which is the inter-governmental body developing and promoting policies to combat money laundering and terrorist financing, published its mutual evaluation report on the U.S. It found that U.S. competent authorities could not obtain beneficial ownership information of corporations and trusts in an adequate, accurate, and timely fashion. In 2015 the IMF also analysed the U.S. Financial Sector on Anti-Money Laundering and Finance of Terrorism[8], as a follow-up of the FATF report, and concluded that these shortcomings remained.

State level

Incorporation of companies in the U.S. is governed by state law and requires the filing of a corporate governance document. However, **many states promoting the creation of corporations by non-residents do not require filing even basic ownership information**. For example, **Arkansas,**

Mississippi, Colorado, Missouri, Delaware, New York, Indiana, Ohio, Iowa, Oklahoma, Maryland, Pennsylvania, Michigan, and Virginia do not require to identify either shareholders or managers[9]. On top of everything, some of these states tend not to share corporate income tax information with the IRS - the US tax administration, charge only minimal fees, involve service providers acting as nominee shareholders and do not verify the submitted information.

Federal Level

At the federal level, in 2010 the U.S. tax authorities (IRS) revised form SS-4 which is used to request an Employer Identification Number (EIN) from corporations and trusts, to include the provision of the name of a 'responsible party'[10] who controls, manages, or directs the entity and the disposition of its funds and assets. However, two problems remain.

- **First, an EIN is not required for corporations that neither maintain an account with a financial institution (FI) nor meet any of several other criteria** (has employees, or has a qualified retirement plan, or files returns for employment taxes, excise taxes or income taxes). In order to address this, the White House's budget proposals for 2015 and 2016 suggested requiring all corporations formed in the U.S. to obtain an EIN. Since neither turned into law, this was recommended again in the budget proposal for 2017 (Budget 2017)[11]. On May 5th, 2016, the U.S. Treasury announced a proposed regulation[12] to require foreign-owned disregarded entities, such as single-member LLCs to obtain an EIN. Even if these proposals were to become applicable, other problems would remain. An analysis by the Financial Accountability & Corporate Transparency (FACT) Coalition[13] explained that *"there is no clear mechanism for enforcing the broad requirement to file the form— […] companies can exist indefinitely and transact business overseas without the federal government knowing they exist, much less obtaining an EIN*".
- **The second problem with form SS-4 relates to the definition of 'responsible party'** and remains unaddressed by the White House 2017 budget proposal and also by the Treasury's 5th May, 2016 proposed regulation on foreign-owned single-member LLCs. Form SS-4 requests companies to provide the name of a 'responsible party' but this term focuses on control but not on ownership of the company and may thus be inconsistent with FATF's definition of 'beneficial owner'. Likewise, the FACT Coalition expressed that *"While this ['responsible party'] could be an owner or primary shareholder, it could also be an officer, director, or high-ranking manager […thus…] the SS-4's current definition of 'responsible party' could allow a company to complete the form without naming a beneficial owner and only requires one person to be listed[14]".* The U.S. Treasury also submitted to Congress draft legislation on beneficial ownership registration[15]. However, the actual text of the proposal is not available as of May 6th, 2016 and it could still suffer changes, let alone not even be approved.

Availability of Anonymous Companies in the U.S. in Practice

The IMF wrote in 2015 that more than 30 million companies, trusts and partnerships exist in the U.S. In 2012, a study published the results of an academic research project which tested whether international rules requiring to collect identity documents from customers are followed by those selling shell companies[16]. The authors of the study reported their findings after sending 7,400 email solicitations to more than 3,700 Corporate Service Providers that set up and sell shell companies in 182 countries. The paper found that:

"only a tiny proportion of U.S. providers of any kind met the international standard by requiring notarized identity documents (10 of 1722 in the U.S. sample, or a proportion of 0.00058%). […] Wyoming, Delaware and Nevada were among the worst in being the most likely to supply untraceable shell companies, a particularly worrying finding in that providers in these states are most likely to sell companies to foreign clients."

And concluded that:

"Obtaining an anonymous shell company is therefore easier in the U.S. than in the rest of the world."

As a matter of fact, as of April 15, 2016, the following incorporation offers are available online:

- An LLC in Nevada within 48-72 hours, with the benefits that "Nevada is the only state in the USA that does not share information even with Internal Revenue Service"[17].
- Another option is an LLC in Delaware where for USD 549 they "email approved documents the same business day as long as the order is placed before 1 PM EST". Delaware, as explained by the Institute on Taxation and Economic Policy (ITEP)[18], "*with roughly 935,000 residents [had] more than 1.1 million companies incorporated there as of 2014, including 65 percent of Fortune 500 parent companies*". **One building alone, the Corporation Trust Center located in 1209 N Orange St, is the legal address of no fewer than 285,000 separate businesses**[19]. ITEP also describes the famous 'Delaware Loophole', which "*allows corporations to set up holding companies in Delaware that the parent company or other subsidiaries then pay for the use of intellectual property. This income is not taxed in Delaware, while the payments can be deducted as a business expense from the parent company's tax liability in its home state*".
- Another option is to purchase already-existing companies (shelf companies) in Wyoming ranging from USD 645 (for LLCs incorporated in April of 2016) all the way up to USD 7.295 (for an LLC incorporated in February of 2007)[20]. The price difference is explained because the older the company, the less suspicious it may look for banks and other regulated entities, compared to a company created for a specific transaction. An older company is also useful to simulate past transactions.

Related to this, the IMF wrote that law-enforcement agencies indicated that "*they commonly come across situations where foreigners launder funds in the United States or other jurisdictions using U.S. corporations*".

B. U.S. FINANCIAL INSTITUTIONS DO NOT NEED TO OBTAIN BENEFICIAL OWNERSHIP INFORMATION

Since 2006 already, the FATF report had found that, contrary to FATF Customer Due Diligence (CDD) requirements, financial institutions in the U.S. were not required to identify beneficial owners in all cases, including in relation to corporations and trusts. The only exceptions (where U.S. financial institutions do have to collect beneficial ownership) referred to correspondent banking[21] (i.e. an account established to receive deposits or make payments for a foreign financial institution) and private banking[22] for non-U.S. clients (i.e. accounts with a minimum deposit of at least USD 1 million).

In a 2012 Roundtable[23] held by the U.S. Financial Intelligence Unit (FinCen), participants acknowledged that "*some financial institutions obtain beneficial ownership information in all circumstances, while some do so only for certain customers (such as certain non-operating entities formed under the laws of foreign jurisdictions) or after a triggering event has been identified. Financial institutions also described varying practices relating to the types of information obtained from customers about beneficial owners (e.g., name and address, name only, etc.)*". Likewise, the 2014 Federal Financial Institutions Examination Manual[24] regarding due diligence for Depositary institutions opening new accounts "*suggests*" Financial Institutions to collect beneficial ownership information if a new customer poses higher risk, "*but this is not a requirement*".

As a consequence of these shortcomings, in 2014 FinCen issued for public comment Proposed Rules for Enhanced Customer Due Diligence. Following the Panama Papers scandal of April 2016, on May 5th, 2016 the U.S. Treasury published the final version of such rules. **However, these final rules contain the same problems identified by the IMF in the 2014-version of the rules. Consequently, the final rules would not be in line with the FATF standard because of the limited scope of regulated entities covered[25] (i.e. insurance companies are not included[26]) and because the Financial Institutions' verification of the identity of beneficial owners would rely mainly on customers' own certification**. In addition, the definition of beneficial owner in these rules is incomplete because it lacks the criterion of 'control through other means'.[27] Indeed, according to the FATF, financial institutions are required to identify who controls a company first through ownership, then through control by other means and only then to identify a person with senior managerial position[28]. Moreover, proposed requirements to identify the beneficial owner **only apply to customers opening new accounts[29]** (not to pre-existing customers), they **do not cover trusts[30]** (unless they own enough equity in an entity, such as a company, required to provide beneficial ownership information) **nor require beneficial ownership information to be updated in the future in case of changes,** unless the financial institution becomes aware of changes when running risk monitoring process[31].

2. UNEQUAL AUTOMATIC EXCHANGE OF INFORMATION BETWEEN THE U.S AND THE E.U.

In 2010 the U.S. enacted the Foreign Account Tax Compliance Act (FATCA) to require all financial institutions (FIs) in the world to provide information to the U.S. tax authorities regarding Americans' financial accounts abroad. The consequence for not complying was a 30% withholding tax on all U.S.-sourced payments to those incompliant FIs. Since complying with FATCA (a U.S. domestic law) would involve breaching the domestic law of most foreign FIs (i.e. banking secrecy laws), the U.S. signed Inter-Governmental Agreements (IGAs) with many countries to provide a legal framework that would allow those foreign FIs to legally provide information to the US tax administration (IRS). Three types of IGAs are available.

- **Model 1** involves exchange of information between the IRS and the foreign tax authority (not directly between the IRS and foreign FIs) and account holders' consent is not required to exchange their information. Model 1 A involves limited reciprocity from the U.S.
- In contrast, **Model 1 B** (signed with Bulgaria[32]) involves no reciprocity from the U.S. and was offered to jurisdictions with which the U.S. had no previous exchange of information relationships. For example Argentina tried to sign a Model 1 A agreement to receive at least some information from the U.S. but the U.S. refused to do so[33], and only offered a Model 1 B instead.
- **Model 2** involves non-reciprocal exchange of information from the foreign FI directly to the IRS about account holders who gave their consent to have their information reported. As of April 7, 2016, 14 jurisdictions[34] signed or have an agreement in substance to have a Model 2 with the U.S., including Austria[35] and Switzerland.

26 EU countries (except Austria and Bulgaria) signed an IGA 1 A and all of them are already in force except for the ones with Belgium, Croatia and Portugal, while Greece has an agreement in substance but not signed yet).

The legal validity of FATCA's IGAs

Even though the U.S. signed more than 100 IGAs, U.S. experts* disagree on the validity of IGAs pursuant to U.S. domestic laws. While IGAs were not approved by Congress, some authors argue that they could still be valid as either 'Congressional-Executive Agreements', 'Treaty-Based Agreements' or biding 'Administrative Guidance'. One U.S. Senator even challenged IGAs in court, although the lawsuit was dismissed. If U.S. Courts determined that IGAs are invalid because they have not been ratified by Congress, this would cause an international scandal. More than 100 countries signed IGAs and changed their own domestic laws accordingly, assuming that the U.S. had the authority to sign these agreements. The Vienna Convention on the Law of Treaties also refers to the principles of good faith and execution (after all, exchanges pursuant to the IGAs have already started to take place). Moreover, countries are not allowed to invoke their domestic law in order to violate an international obligation. In any case, based on the May 5th, 2016 submissions of the U.S. Treasury to Congress, it appears that achieving full reciprocity in IGAs will depend on Congress' approval.

* See end note

Parallel to this, **all EU countries committed to implement multilateral automatic exchange of information pursuant to the OECD's Common Reporting Standard (CRS) which requires full reciprocity** from all jurisdictions and has almost the same scope of information to be reported as FATCA except for some FATCA exemptions[36]. All EU countries signed the Multilateral Competent Authority Agreement (MCAA)[37] to implement the CRS and committed to start exchanging information in 2017, except for Austria which chose to start in 2018. In contrast, the U.S. decided not to implement the CRS, but to apply only FATCA instead.

This means that EU countries will provide, under automatic exchange, the maximum scope[38] of information to the U.S. (pursuant to IGAs) and to the rest of the jurisdictions implementing the CRS (pursuant to the MCAA). **In contrast, the U.S. will receive the maximum scope of information from the EU and from many other countries (pursuant to IGAs), but will only send limited information to most EU countries, and no information whatsoever to Austria, Bulgaria, Switzerland and many other countries that either signed a Model 2 IGA, Model 1 B or that did not manage to sign a IGA 1 A at all (like Argentina, which did sign the MCAA).**

A. EXPLICIT LACK OF RECIPROCITY

All signed IGAs 1 A with EU countries acknowledge the lack of reciprocity by the U.S. in Article 6: "***The Government of the United States acknowledges the need to achieve equivalent levels of reciprocal automatic information exchange with [FATCA Partner]****. The Government of the United States is committed to further improve transparency and enhance the exchange relationship with [FATCA Partner] by pursuing the adoption of regulations and advocating and supporting relevant legislation to achieve such equivalent levels of reciprocal automatic information exchange*" (emphasis added). **Importantly, no timeframe is established so the U.S. commitment to reciprocity is unenforceable.** Likewise, the U.S. Treasury acknowledged in its letter to Congress of May 5th, 2016 that "*the United States does not provide its FATCA partners with the same information about U.S. financial institutions that foreign financial institutions must provide to the IRS*".

The lack of reciprocity is also confirmed by the OECD when listing the jurisdictions committing to the CRS as of May 9th, 2016. While there is a list of jurisdictions committing to the CRS in 2017 and in 2018 the U.S. is isolated in a footnote with the following comment: "*The United States has indicated that it is undertaking automatic information exchanges pursuant to FATCA from 2015 and has entered into intergovernmental agreements (IGAs) with other jurisdictions to do so. The Model 1A IGAs entered into by the United States acknowledge the need for the United States to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions. They also include a political commitment to pursue the adoption of regulations and to advocate and support relevant legislation to achieve such equivalent levels of reciprocal automatic exchange*."[39].

OECD
BETTER POLICIES FOR BETTER LIVES

Global Forum on Transparency
and Exchange of Information for Tax Purposes

As at 9 May 2016

AEOI: STATUS OF COMMITMENTS
(101 jurisdictions have committed)

The table below summarises the intended implementation timelines of the new standard.[1]

JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2017 (55)
Anguilla, Argentina, Barbados, Belgium, Bermuda, British Virgin Islands, Bulgaria, Cayman Islands, Colombia, Croatia, Curaçao, Cyprus, Czech Republic, Denmark, Dominica, Estonia, Faroe Islands, Finland, France, Germany, Gibraltar, Greece, Greenland, Guernsey, Hungary, Iceland, India, Ireland, Isle of Man, Italy, Jersey, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Montserrat, Netherlands, Niue, Norway, Poland, Portugal, Romania, San Marino, Seychelles, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Trinidad and Tobago, Turks and Caicos Islands, United Kingdom
JURISDICTIONS UNDERTAKING FIRST EXCHANGES BY 2018 (46)
Albania, Andorra, Antigua and Barbuda, Aruba, Australia, Austria, The Bahamas, Bahrain, Belize, Brazil, Brunei Darussalam, Canada, Chile, China, Cook Islands, Costa Rica, Ghana, Grenada, Hong Kong (China), Indonesia, Israel, Japan, Kuwait, Lebanon, Marshall Islands, Macao (China), Malaysia, Mauritius, Monaco, Nauru, New Zealand, Panama, Qatar, Russia, Saint Kitts and Nevis, Samoa, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Singapore, Sint Maarten, Switzerland, Turkey, United Arab Emirates, Uruguay, Vanuatu

1 The United States has indicated that it is undertaking automatic information exchanges pursuant to FATCA from 2015 and has entered into intergovernmental agreements (IGAs) with other jurisdictions to do so. The Model 1A IGAs entered into by the United States acknowledge the need for the United States to achieve equivalent levels of reciprocal automatic information exchange with partner jurisdictions. They also include a political commitment to pursue the adoption of regulations and to advocate and support relevant legislation to achieve such equivalent levels of reciprocal automatic exchange.

B. LACK OF RECIPROCITY IN THE SCOPE OF INFORMATION TO BE EXCHANGED

Article 2 of IGA 1 A contains reporting obligations for non-U.S. financial institutions and then for U.S. financial institutions. Graphically, the lack of reciprocity is ostensible[40]:

EU FINANCIAL INSTITUTIONS' OBLIGATIONS	U.S. FINANCIAL INSTITUTIONS' OBLIGATIONS
a) In the case of [FATCA Partner] with respect to each U.S. Reportable Account of each Reporting [FATCA Partner] Financial Institution: (1) the name, address, and U.S. TIN of each Specified U.S. Person that is an Account Holder of such account and, in the case of a Non-U.S. Entity that, after application of the due diligence procedures set forth in Annex I, is identified as having one or more Controlling Persons that is a Specified U.S. Person, the name, address, and U.S. TIN (if any) of such entity and each such Specified U.S. Person; (2) the account number (or functional equivalent in the absence of an account number); (3) the name and identifying number of the Reporting [FATCA Partner] Financial Institution; (4) the account balance or value (including, in the case of a Cash Value Insurance Contract or Annuity Contract, the Cash Value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year, immediately before closure; (5) in the case of any Custodial Account: (A) the total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and (B) the total gross proceeds from the sale or redemption of property paid or credited to the	b) In the case of the United States, with respect to each [FATCA Partner] Reportable Account of each Reporting U.S. Financial Institution: (1) the name, address, and [FATCA Partner] TIN of any person that is a resident of [FATCA Partner] and is an Account Holder of the account; (2) the account number (or the functional equivalent in the absence of an account number); (3) the name and identifying number of the Reporting U.S. Financial Institution; (4) the gross amount of interest paid on a Depository Account; (5) the gross amount of U.S. source dividends paid or credited to the account; and (6) the gross amount of other U.S. source income paid or credited to the account, to the extent subject to reporting under chapter 3 of subtitle A or chapter 61 of subtitle F of the U.S. Internal Revenue Code

account during the calendar year or other appropriate reporting period with respect to which the Reporting [FATCA Partner] Financial Institution acted as a custodian, broker, nominee, or otherwise as an agent for the Account Holder; (6) in the case of any Depository Account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period; and (7) in the case of any account not described in subparagraph 2(a)(5) or 2(a)(6) of this Article, the total gross amount paid or credited to the Account Holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the Reporting [FATCA Partner] Financial Institution is the obligor or debtor, including the aggregate amount of any redemption payments made to the Account Holder during the calendar year or other appropriate reporting period.	

Compared to EU financial institutions, this is the information that U.S. financial institutions will not need to report[41]:

- Depositary Accounts held by EU-resident entities (i.e. companies, trusts);
- Depositary Accounts held by EU-resident individuals if they earn less than $10 in interest (that is why U.S. FIs wanted to offer no-interest accounts, to allow individuals to be below the threshold and avoid reporting[42]);
- Account Balance of Custodial accounts (i.e. holding shares) held by EU residents
- Foreign-sourced dividends (EU FIs will need to report all dividends paid or credited to the account, while U.S. FIs will report only *U.S-sourced* dividends paid).
- Other income and proceeds from sale or redemption of property, except if they are sourced in the U.S. and if they are already subject to reporting pursuant to the U.S. tax code, Chapters 3 and 61[43].

C. NO EXCHANGE OF BENEFICIAL OWNERSHIP INFORMATION BY THE UNITED STATES

An individual trying to circumvent automatic exchange of information could try to hold a bank account via an entity (i.e. a company or trust) instead of holding it directly under its own name. For this reason, both FATCA and the CRS require that for accounts held by entities which have mostly passive income (i.e. income from interest, dividend, etc.), financial institutions have to 'look-through' such entities (called 'Passive Non-Financial Entities') to identify and report its beneficial owners (called 'controlling persons' for FATCA and the CRS purposes). This would prevent the possibility of putting a screen (in the form of a

company or trust) between you and your bank account.

However, FATCA only demands this from the other country's financial institutions while U.S. financial institutions do not need to identify nor report any beneficial ownership information[44]. However**,** even if U.S. financial institutions were required in the future to report information on beneficial owners to the EU, they would not be able to do so under current U.S. laws. As demonstrated above, neither current U.S. laws nor the final rules announced on May 5th, 2016 require U.S. financial institutions to collect information on beneficial owners for all circumstances covered by FATCA and the CRS.

D. ONLY EU FINANCIAL INSTITUTIONS MAY BE SANCTIONED WITH FATCA'S FAMOUS 30% WITHHOLDING TAXES

FATCA agreements (IGAs) signed between the U.S. and most EU countries to exchange information require all authorities to apply their domestic law to ensure compliance from financial institutions. **However, FATCA's famous sanction in the form a 30% withholding tax on all U.S.-sourced payments towards incompliant financial institutions is only applicable against EU financial institutions, not U.S. ones.** If EU financial institutions remain incompliant for more than 18 months, the U.S. may impose such 30% withholding tax, regardless of any EU domestic penalty imposed. This does not apply to U.S. financial institutions, showing a difference of treatment. One recommendation below addresses this difference by proposing a similar 30% withholding tax on all EU-sourced payments towards incompliant financial institutions (including U.S. ones).

3. THE U.S. SLOWING DOWN PROGRESS TOWARDS GLOBAL AUTOMATIC EXCHANGE OF INFORMATION

While the OECD standard for automatic exchange of information (CRS) is based on FATCA, it is not exactly the same (especially given the lack of reciprocity from the U.S.). For this reason, it was always intended from the beginning that the U.S. would also join the CRS. A special incentive (exclusive for the U.S.) was included for this regard: U.S. financial Institutions would not need to collect information on beneficial owners from investment entities located in jurisdictions not participating in the CRS[45], unlike financial institutions from any other country. This unequal treatment for U.S. Financial Institutions caused criticism by the Swiss Banking Association[46]. Nevertheless, the U.S. decided not to implement the CRS but only FATCA. Interestingly, the OECD[47] did not include the U.S. together with the other jurisdictions highlighted for not committing to the CRS (Bahrain and Panama).

In fact, Panama refused in the past to implement the CRS quoting the U.S. and suggesting it should also be allowed to develop its own bilateral mechanism for automatic exchange of tax information: "*President Juan Carlos Varela in October announced that Panama will proceed with this exchange, but in a bilateral way, similar to what the United States has done*" reported La Prensa[48] on March 1, 2016. However, as a result of the Panama Papers, Panama will commit to the CRS[49] An official letter from Panama was sent to the OECD on May 9th, 2016 to confirm that the country will automatically exchange tax information as of 2018.

RECOMMENDATIONS

In light of all the expressed above, and in order to support global transparency to tackle financial crimes, the EU should promote that all countries:

1. **Establish central public registries of beneficial ownership information for all types of legal persons (i.e. companies) and legal arrangements (i.e. trusts)** created under their laws or operating in their territories. These registries should be publicly accessible, online, free and in open data format, to allow information to be cross-checked and analysed both by authorities and the public (civil society organizations, journalists, etc.) and ideally internationally connected.

   Such registries would be highly superior to the April 2016 proposal by the Finance Ministers of Germany, the United Kingdom, France, Spain and Italy to exchange beneficial ownership information automatically. The main concerns with this plan is that it does not necessarily involve beneficial ownership information to be held by an official registry but rather to have information 'available to authorities' (which would rely on service providers or companies themselves– potentially involved in a financial crime - to faithfully keep and provide accurate information when requested). The other problem is that the general public would likely not have access to beneficial ownership information automatically exchanged among authorities. In contrast, public registries would reduce the costs of sharing information and would guarantee direct access by civil society organizations or journalists. This would also contribute to the accuracy of the information.

2. **Commit to global automatic exchange of information pursuant to the OECD's Common Reporting Standards** by becoming party to the Amended OECD Convention on Mutual Administrative Assistance in Tax Matters, signing the Multilateral Competent Authority Agreement (MCAA), and choosing to exchange information with all other co-signatories of the MCAA.

3. **Publish aggregate information on the financial assets held by non-residents (according to country of residence) in their financial institutions**, based on the example of the law approved by Australia. The aggregate information to be published could be similar to the table by country of origin published by the German state of North Rhine-Westphalia regarding bank information bought from informants. This would enable developing countries unable to join the Common Reporting Standard to obtain basic information about the total assets held by their residents in each financial centre, and for the public to have some data about money held offshore, to hold authorities accountable.

In order to encourage the level playing field in terms of automatic exchange of information, the EU could:

4

Carefully screen the U.S. according to the criteria which will be developed for a common European black list of tax havens. The European Commission announced in January 2016 its intention to work with Member States to create a common single black list of non-cooperative third country jurisdictions. Given that the U.S. allows companies to be created without providing beneficial ownership information, and that the exchange of information between EU and U.S. tax authorities is not fully reciprocal (nor has the U.S. committed to implement the OECD Common Reporting Standard for automatic exchange of tax information), the European Commission and Member States should seriously consider including the United States on their upcoming blacklist of tax havens.

5

Establish a withholding tax scheme, on all EU-sourced payments against non-compliant financial institutions, similar to what the U.S. did with FATCA [50]. This will provide a strong incentive for them (and thus the countries where they are located) to implement the Common Reporting Standard (or equivalent levels of information exchange). In a second stage, sanctions could also be used to ensure that financial institutions from financial centres will also provide information to developing countries with which the European Union is already exchanging information.

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[1] http://www.financialsecrecyindex.com/

[2] http://www.financialsecrecyindex.com/introduction/fsi-2015-results

[3] See page 9 here: https://www.city.ac.uk/__data/assets/pdf_file/0011/287138/CITYPERC-WPS-201502.pdf

[4] http://www.bea.gov/international/xls/fdius-current/FDIUS%20ctry%20by%20ind%20Position%202010-2014.xlsx

[5] http://www.economist.com/news/international/21693219-having-launched-and-led-battle-against-offshore-tax-evasion-america-now-part; http://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states; and https://www.washingtonpost.com/news/wonk/wp/2016/04/05/how-the-u-s-became-one-of-the-worlds-biggest-tax-havens/

[6] Trusts, in contrast, tend to be a problem in almost all jurisdictions because they hardly ever need to be registered with a commercial registry, and tax authorities only register them in limited circumstances. In addition, ownership information need not always be reported. The FSI analyses this.

[7] The Global Forum wrote regarding the U.S. legal framework: "[Where] a single-member LLC is not engaged in a U.S. trade or business, has no fixed, determinable, annual, or periodical gains, profits, or income, and does not otherwise have a tax nexus with the United States, there is no obligation to file a federal income tax return with the IRS. […] Pursuant to State laws, an LLC must know who its members are but ownership information is generally not required to be provided to the State's authorities, either at the time the LLC is formed or subsequently. Neither is it required to be kept in the United States. Similarly, only limited information may be required to be reported in respect of the LLC's management. All states require that a registered agent be appointed for service of process. This agent is not required to know the owners of the company. Accordingly, where a single member LLC has no tax nexus with the United States there may be no information available in the United States regarding the owners of that LLC".

[8] http://www.imf.org/external/pubs/ft/scr/2015/cr15174.pdf

[9] Massachusetts, Tennessee, North Carolina, Vermont, Rhode Island, Wisconsin, South Carolina, the District of Columbia, and South Dakota require an LLC to report the identities of managers only. California, Nebraska, Connecticut, Nevada, Florida, New Hampshire, Georgia, New Jersey, Hawaii, New Mexico, Idaho, North Dakota, Illinois, Oregon, Kentucky, Texas, Louisiana, Utah, Maine, Washington, Minnesota, West Virginia, Montana, and Wyoming require an LLC to report the identities of shareholders only when it lacks managers.

[10] For all other entities except the publicly traded companies, "'Responsible party' is the person who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets": https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Responsible-Parties-and-Nominees

[11] See page 211 here: https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf

[12] https://www.treasury.gov/press-center/press-releases/Pages/jl0451.aspx, and https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-10852.pdf

[13] http://thefactcoalition.org/

[14] The FACT Coalition paper also adds that "Many positive elements of the Incorporation Transparency bill are not covered by this definition [of 'responsible party']: collection of information about those who hold the ultimate economic and legal interests in the company, information on multiple beneficial owners, information on owners who cede or assign legal control to another person, and individuals who derive economic benefits from the entity without technically owning it. These limitations make this information much less useful to law enforcement, but there is no indication in the proposal as to whether the administration is open to strengthening the definition or requiring multiple beneficial owners to be listed on the form".

[15] https://www.treasury.gov/press-center/press-releases/Pages/jl0451.aspx

[16] Findley, Nielson and Sharman, Global Shell Games: Testing Money Launderers' and Terrorist Financiers' Access to Shell Companies https://www.griffith.edu.au/__data/assets/pdf_file/0008/454625/Oct2012-Global-Shell-Games.Media-Summary.10Oct12.pdf

[17] https://www.delawareinc.com/ourservices/compare-domestic-packages/

[18] http://itep.org/itep_reports/2015/12/delaware-an-onshore-tax-haven.php#.VylYLjArLIU

[19] http://www.nytimes.com/2012/07/01/business/how-delaware-thrives-as-a-corporate-tax-haven.html?_r=0

[20] http://wyomingcompany.com/aged-corporation/

[21] "[T]he USA PATRIOT Act, which defines a correspondent account broadly to include any account established for a foreign financial institution to receive deposits from, or to make payments or other disbursements on behalf of, the foreign financial institution, or to handle other financial transactions related to such foreign financial institution. While this is a relatively broad definition, it requires a formal relationship through which the financial institution provides regular services" (https://www.fincen.gov/news_room/rp/rulings/html/312factsheet.html)

[22] "the USA PATRIOT Act, which defines a private banking account as an account that is established or maintained for the benefit of one or more non-U.S. persons, requires a minimum aggregate deposit of funds or other assets of not less than $1,000,000, and is assigned to a bank employee who is a liaison between the financial institution and the non-U.S. person" (https://www.fincen.gov/news_room/rp/rulings/html/312factsheet.html)

[23] https://www.fincen.gov/whatsnew/html/20121130NYC.html

[24] Pages 57-58 available here: https://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2014.pdf. This Manual was produced by the Federal Financial Institutions Examination Council (comprising the five Federal Banking Agencies) and provides guidance to federally-regulated banks, credit unions and trust companies. While the guidance has no direct force of law, non-compliance would provide a basis for administrative enforcement action (2006 FATF Mutual Evaluation Report on the U.S.).

[25] Insurance companies or brokers, money or value transfer services, foreign exchange bureaus, investment advisers and commodity trading advisors, and trust and company service providers were not covered by the proposed requirements (IMF 2015: 11). **This is also relevant for AEOI** because for the OECD's CRS, some insurance companies, investment advisors and trusts may be considered "reporting financial institutions". In such case, they should be able to collect and report BO information when applicable.

[26] The term "covered financial institution" refers to: (i) banks; (ii) brokers or dealers in securities; (iii) mutual funds; and (iv) futures commission merchants and introducing brokers in commodities. (Footnote 3, page 3), available here: https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-10567.pdf

[26] "FinCEN is revising § 1010.230(b)(2) in the final rule to clarify that a covered financial institution may rely on the information supplied by the legal entity customer regarding the identity of its beneficial owner or owners, provided that it has no knowledge of facts that would reasonably call into question the reliability of such information" (page 39), available here: https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-10567.pdf

[27] The IMF wrote: "for control it [FinCen proposed rules] focuses on those who manage the corporation and does not require the names of those who control the corporation through other means unless such control flows from owning 25 percent or more of the corporation's equity". Specifically, 2012 FATF Recommendations has cascading measures to identify the BO which include (i) control via ownership, then (ii) control through other means, and (iii) if no one meets criteria (i) and (ii), the person with senior manager position may be identified (see 2012 FATF Recommendations page 60, especially footnote 29: http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf). It appears that FincCen 2014 rules are missing the FATF's option ii of the cascade when it considers that when no person has ownership control (FinCen's 'ownership prong' or FATF's criterion (i)), then the person with senior managerial position may be identified (Fincen's 'control prong' or FATF's criterion (iii)), but not 'the person with control through other means' (FATF's criterion (ii)). Explicitly, Fincen 2014 states "if no one individual owns 25 percent or more of the equity interests, then the financial institution may identify no individuals under the ownership prong. Under the control prong (clause (2)), a financial institution must identify one individual. […] Control Prong: 2. An individual with significant responsibility to control, manage, or direct a legal entity customer, including (A) An executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member,

General Partner, President, Vice President, or Treasurer); or (B) Any other individual who regularly performs similar functions".

[28] See note above.

[29] "We decline to impose a categorical, retroactive requirement. Based on our understanding of the significant changes to processes and systems that will be required to implement this requirement simply on a prospective basis, we believe that retroactive application would be unduly burdensome" (page 28) and "Accordingly, in the final rule, § 1010.230(b)(1) is revised to state that covered financial institutions must identify the beneficial owner(s) of each legal entity customer at the time a new account is opened, unless the customer is otherwise excluded or the account is exempted" (page 29-30), available here: https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-10567.pdf

[30] "FinCEN proposes to define legal entity customers to include corporations, limited liability companies, partnerships or other similar business entities (whether formed under the laws of a state or of the United States or a foreign jurisdiction), that open a new account after the implementing date of the regulation. […] It does not include trusts other than those that might be created through a filing with a state (e.g., statutory business trusts)".

[31] "Many financial institutions sought clarity as to whether they would be required to update or refresh periodically the beneficial ownership information obtained under this rule. FinCEN is not proposing such a requirement but notes that, as a general matter, a financial institution should keep CDD information, including beneficial ownership information, as current as possible and update as appropriate on a risk-basis".

[32] https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Bulgaria-12-5-2014.pdf

[33] http://www.lanacion.com.ar/1713603-bancos-argentinos-daran-a-eeuu-datos-de-sus-clientes-norteamericanos

[34] https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx

[35] https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Austria-4-29-2014.pdf

[36] For instance, depositary accounts held by individuals which are below USD 50.000 need not be reported. See Model IGA 1 A , Annex I, Section II.A and III.A here: https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Annex-I-to-Model-1-Agreement-6-6-14.pdf

[37] https://www.oecd.org/ctp/exchange-of-tax-information/MCAA-Signatories.pdf

[38] Information that has to be provided to the U.S. for each applicable account includes: name, address, and U.S. TIN of U.S. account holders (including of U.S. BOs when applicable); account number; name and identifying number of the EU FI; account balance or value; interest, dividends, other income and proceeds from sale or redemption of property (in all cases regardless of the source of such income, so not only EU-sourced payments) (Article 2.2.a) of IGA 1 A).

[39] https://www.oecd.org/tax/transparency/AEOI-commitments.pdf

[40] For a readable version of this comparison, see: http://www.taxjustice.net/wp-content/uploads/2013/04/FATCA-difference-between-US-and-Germany.pdf

[41] For the legal sources of these differences see the table here: http://www.taxjustice.net/2015/01/26/loophole-usa-vortex-shaped-hole-global-financial-transparency-2/ and here (page 4): http://www.anaford.ch/wp-content/uploads/2015/11/Trusts%20&%20Trustees-2015-Cotorceanu-tandt_ttv178.pdf

[42] The term "[FATCA Partner] Reportable Account" means a Financial Account maintained by a Reporting U.S. Financial Institution if: (i) in the case of a Depository Account, the account is held by an individual resident in [FATCA Partner] and more than $10 of interest is paid to such account in any given calendar year; or (ii) in the case of a Financial Account other than a Depository Account, the Account Holder is a resident of [FATCA Partner], including an Entity that certifies that it is resident in [FATCA Partner] for tax purposes, with respect to which U.S. source income that is subject to reporting under chapter 3 of subtitle A or chapter 61 of subtitle F of the U.S. Internal Revenue Code is paid or credited.

The term "U.S. Reportable Account" means a Financial Account maintained by a Reporting [FATCA Partner] Financial Institution and held by one or more Specified U.S. Persons or by a Non-U.S. Entity with one or more Controlling Persons that is a Specified U.S. Person. Notwithstanding the foregoing, an account shall not be treated

as a U.S. Reportable Account if such account is not identified as a U.S. Reportable Account after application of the due diligence procedures in Annex I.

[43] It appears that this refers to information that has to be reported under form 1042 and would include U.S.-sourced rents, royalties, interests on U.S. government bonds or corporate bonds and –among other - insurance premiums, and would exclude capital gains: https://www.irs.gov/instructions/i1042s/ch01.html#d0e790

[44] This provision of Article 2.2.a) on EU Fis' obligations is missing from Article 2.2.b) on U.S. FIs' obligations: "The information to be obtained and exchanged is: […] in the case of a Non-U.S. Entity that, after application of the due diligence procedures set forth in Annex I, is identified as having one or more Controlling Persons that is a Specified U.S. Person, the name, address, and U.S. TIN (if any) of such entity and each such Specified U.S. Person"

[45] CRS, page 6, para. 8: "it is compatible and consistent with the CRS for the US to not require the look through treatment for investment entities in Non-Participating Jurisdictions": https://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf

[46] "[a] provision was introduced for the US in the Common Reporting Standard (CRS) that can be misused as a loophole for clients of US banks. As a result of this provision, clients will continue to be able to hide behind certain offshore vehicles (CRS Part I, Section I. Point 8). The SBA expects these aspects to be addressed in future monitoring carried out by the OECD's Global Forum": http://www.swissbanking.org/en/stellungnahme-20140213.htm

[47] https://www.oecd.org/tax/transparency/AEOI-commitments.pdf

[48] http://www.prensa.com/in_english/Panama-pide-OCDE-acepte-modelo_21_4427767180.html

[49] http://www.ey.com/Publication/vwLUAssets/Panama_commits_to_implementing_OECDs_Common_Reporting_Standard_as_of_2018/$FILE/2016G_00674-161Gbl_PA%20commits%20to%20implementing%20OECDs%20Common%20Reporting%20Standard%202018.pdf

[50] It is necessary to explicitly identify "financial centres" which are recalcitrant, otherwise developing countries that are not tax havens would face sanctions only because they still lack the resources to implement the CRS. An objective measure of financial centres would have to be devised, to avoid political lobbying by other countries.