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Tax Evasion

U.S.-Caymans FATCA Agreement Signals Growing Tax Transparency, Practitioners Say

The new agreement between the United States and the Cayman Islands to implement the Foreign Account Tax Compliance Act is a milestone in a journey toward ever-expanding exchange of tax information between countries, practitioners said Aug. 15 and 16.

The pact is significant because it is in a major financial center that is home to operations for dozens of banks large and small and a huge number of funds and wealth management entities, practitioners said. Among the major banks that do business in the Cayman Islands are the Royal Bank of Canada, HSBC Holdings Plc, Bank of Nova Scotia, Bank of America Corp., Deutsche Bank AG, UBS AG, and FirstCaribbean International Bank.

Practitioners cautioned that financial institutions still have work to do to comply with the anti-evasion U.S. law, which requires reporting of U.S.-owned accounts by foreign banks and other financial entities. The Caymans agreement, accompanied by a new and broader tax information accord, symbolizes the rapid increase of tax transparency around the globe, they said.

Corwin Sees Milestone. ''I think that it is a milestone,'' Manal Corwin, who recently left a senior U.S. Treasury position where she was deeply involved in FATCA policy work, said Aug. 15. ''Step by step, you're seeing this broadening to a global standard,'' Corwin, now head of international corporate tax services at KPMG LLP, said in an interview.

The Cayman Islands government announced Aug. 14 that it has concluded negotiations with the United States on the pact, the first intergovernmental agreement (IGA) with a non-treaty country under the 2010 law (158 DTR G-4, 8/15/13). Several other Caribbean jurisdictions with significant financial industries, such as Bermuda and the Bahamas, are among the dozens of countries now in discussions on similar accords.

At its most basic level, FATCA requires foreign financial institutions to report U.S.-owned accounts directly to the U.S. Internal Revenue Service or face, in some cases, a 30 percent withholding tax.

Intergovernmental agreements allow banks to share the information with their own governments, which then pass the data on to IRS. In general, no withholding tax will be due on payments in an IGA country—a feature that has made the accords attractive to jurisdictions around the world—although banks must still engage in due diligence and report the accounts.

Progress Seen on Information Exchange. Corwin, former Treasury deputy assistant secretary of tax policy for international tax affairs, said the fact that countries such as the Cayman Islands, Bermuda, and the Bahamas are participating in the IGA process shows that progress is being made toward greater information exchange in many parts of the world.

Speaking to BNA Aug. 15, Denise Hintzke, global FATCA leader for Deloitte Tax LLP, said ''in reality, I think we are moving toward more global information exchange. This is the first step toward being able to do that.''

Hintzke said it is significant that the Cayman Islands is entering into a ''Model 1'' FATCA agreement. ''It means that they're taking on the responsibility of FATCA guidance and regulations and they will take responsibility for enforcing the requirements of the law,'' she told BNA. ''It means that they are going to step into the role of getting information directly from their financial institutions.''

In another Aug. 15 interview, John Harrington, a former Treasury international tax counsel, said, ''There is certainly a push toward broader information exchange and automatic exchange. This is reflective of that broader movement.''

In general, practitioners said the agreement itself was not a surprise, because the Cayman Islands has already said it was working on an IGA. The islands' government announced an action plan to fight tax evasion in June (122 DTR I-2, 6/25/13).

Benefits of IGAs. Jonathan Jackel, senior counsel at Burt, Staples & Maner LLP, said what is initially surprising is that the Cayman Islands, which is home to operations for thousands of financial entities, has been very vocal in supporting FATCA—a law that requires reporting of financial accounts.

''Financial centers are a very important part of the Caymans economy,'' Jackel told BNA in an Aug. 16 interview. ''The fund industry is a very significant part of the picture.'' He said with the benefits available through an IGA, there appeared to be a sense in the government that ''We need to do this in order to compete.''

He noted that one of the biggest difficulties under FATCA is rules that ''grandfather'' in certain entities for purposes of the withholding tax. With the removal of the withholding tax in most cases under an IGA, ''that gets rid of a huge complication,'' Jackel said. Now financial entities can focus on due diligence,'' he told BNA.

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U.S. Treasury Deputy Assistant Secretary (International Tax Affairs) Robert Stack said in the Caymans government's news release announcing the agreement that Treasury is ''especially pleased'' that the pact will provide certainty to the islands' ''significant fund industry.''

Harrington also said the benefits of an IGA, including the general absence of withholding taxes, were likely appealing to the Caymans government. There is a tradeoff, he said, of '' 'We'll give you the information you want in exchange for the greater freedom of our institutions.' ''

The Dentons attorney said IGAs are also attractive to U.S. payors who may be confronted with withholding. ''You want to know for sure what the treatment is going to be,'' he said in the Aug. 15 interview.

Banks Still Facing Work. Hintzke, Corwin, and other practitioners cautioned that although IGAs do contain benefits, banks still have a lot of work to do to comply with FATCA.

''Financial institutions still have to engage in due diligence to identify U.S. accounts and they still have to do the reporting,'' albeit to their own governments, Corwin said, stressing that the IGA does not replace the FATCA requirements. ''Everybody has to comply.''

Hintzke also stressed that banks have to register under FATCA and they still need to document and identify their account holders. The fact that the Cayman Islands entered into an IGA doesn't necessarily change what FFIs have to do,'' she said. However, she added, ''The means by which they do it will be affected by the IGA.''

Jackel, too, said there still may be burdens. ''There's still a very big mountain to climb in terms of dealing with an existing base of clients or investors,'' he told BNA.

Accounts Seen Increasingly Subject to Scrutiny. Dennis Brager, a former IRS senior trial attorney who now heads Brager Tax Law Group APC, said the pact with the Caymans is another indication that taxpayers' accounts are increasingly vulnerable to government scrutiny on multiple fronts.

''The Caymans have traditionally been thought of as a secrecy jurisdiction, as was Switzerland,'' he said in an Aug. 15 interview. ''They're falling like dominoes.''

He said taxpayers who do have foreign accounts need to prepare themselves for the fact that their banks will soon be reporting detailed information to the United States. ''People come into my office in utter shock,'' he said. ''They thought their bank was too small or their country too remote or the information was too deep. The truth is that your information is going to be turned over.''

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