

The Mechanics of How Information Gets Exchanged

There are two forms of exchange: a Model 1 IGA and a Model 2 IGA. We will begin with a discussion of the latter.

a. Model 2 IGA

Under a Model 2 Agreement, the Swiss government authorizes Swiss financial institutions to report U.S. account information directly to the IRS without the threat of prosecution.ⁱ Thus, these institutions are guaranteed immunity from prosecution at the hands of the Swiss government.ⁱⁱ Prior to the enactment of Model 2, Swiss banking laws were once extremely protective of client anonymity. Indeed, any bank (or bank representative) that revealed the details of a client's account to a foreign taxing authority could be charged with breaking Swiss bank secrecy laws, be prosecuted, and if convicted, sent to prison.

Thus, a demand by the U.S. government (or any government) for the names and account holder information of U.S. account holders put Swiss banks and bank personnel between a rock and a hard place. On the one hand, if they complied with the summons and exchanged such information, they would be breaking Swiss law and could be hauled into court and prosecuted by the Swiss government. On the other hand, if they thumbed their noses in the face of Uncle Sam, they could become the target of a U.S. investigation more probing than a rectal examination. Model 2 changed all of that.

The Foreign Financial Institution (FFI) must provide the IRS with “nameless aggregates,” no questions asked. Aggregate reporting refers to the aggregate number of “non-consenting U.S. accounts” – along with their total value – that are held by the foreign bank.ⁱⁱⁱ Such information must be reported to the U.S. government, without disclosing the identity of the respective clients.

The FFI must identify all U.S. account holders whose account information is contained within the aggregate information reported. It must then notify the respective account holders and **obtain their consent** before disclosing their complete information (i.e., taxpayer identification number (TIN), name, address and date of birth) to the IRS.^{iv} This notice is called a “declaration of consent,” and lists the “parade of horrors” that a U.S. account holder can expect to face if he does not consent.

What happens next is nothing short of gamesmanship. Some U.S. account holders will consent. Others will give their foreign bank the “Italian Salute” and tell them where to go. Those account holders who refuse to consent are referred to by the IRS in the not-so-flattering term as “recalcitrant account holders.”

The FFI will provide the IRS with complete information on each of the accountholders who consent. Those who withhold their consent might just as well be fighting an “uphill battle” because the IRS has the right to demand complete information on all recalcitrant accountholders by making a “group request.” A group request is just that: a “demand for complete information on all *recalcitrant* accountholders.”^v

Upon receipt of such a demand, the FFI must provide “complete information on all recalcitrant accountholders” to its “*respective government* for exchange with the IRS.”^{vi} Note a subtle point: in dealing with recalcitrant accountholders, the exchange of information is *not* made directly from the FFI to the IRS. Instead, the exchange is made from the FFI to its foreign government.

The foreign government, in turn, “has six months to provide the requested information [to the U.S. government], in the same format as it would have been reported if the FFI had reported directly to the IRS.”^{vii} However, the taxpayer has the right to challenge the group request in Swiss court, albeit against unspeakable odds (see below).

b. Model 1 IGA

Under a Model 1 IGA, a foreign financial institution must report information directly to its respective government.^{viii} The government, in turn, automatically exchanges this information with the tax authority in the relevant partner country once per year “pursuant to an income tax treaty or exchange of information agreement.”^{ix} When it comes to the United States, the relevant tax authority is none other than the IRS.

Thus, Model 1 IGA contemplates a “direct” and “automatic” exchange of information between taxing authorities.^x A simple way of viewing automatic exchange is as a box full of confidential documents that is covered in wrapping paper, adorned with a bow, and delivered to the doorstep of the IRS, complements of the Swiss taxing authority.

c. Major Differences Between Model 1 and Model 2

First, under Model 1, a foreign government “serves as an intermediary to the supply of information from FFIs to the United States.”^{xi} Under Model 2, foreign financial institutions report directly to the IRS. The only time that a Model 2 implicates a foreign government is when the IRS makes a group information request. Then and only then must the foreign government provide specific U.S. accountholder information *directly* to the IRS. This might shed light on why Model 1 IGAs are disfavored: they place a greater administrative burden on the foreign government.

The second difference is the requirement under Model 2 IGA that FFIs first obtain the consent of U.S. accountholders *before* reporting their specific account information to the IRS.^{xii} Indeed,

nothing short of a U.S. accountholder's unbridled consent is required before an FFI can report that information to the IRS. On the contrary, accountholder consent is *not* required under Model 1 IGA because accountholder information is being exchanged *automatically* between the tax authorities of two countries.

d. The Takeaway

At the end of the day, a group request provides the IRS with the same information that the FFI would have reported to the IRS had it originally obtained the accountholder's consent. The only difference is that it takes two steps – aggregate reporting and a group request – instead of just one. In that sense, a Model 2 IGA does *indirectly* what an automatic exchange under a Model 1 IGA does *directly*.^{xiii}

e. Change is on the Horizon

The Swiss government will soon be transitioning to a Model 1 Treaty within the next few years, whereby the Swiss government will be exchanging information directly to the IRS and other countries' taxing authorities.

ⁱ William Byrnes and Robert Munro, FATCA and Switzerland: Model II, LexisNexis Guide to FATCA Compliance, Ch. 19, May 2013, available online at www.lexisnexis.com/legalnewsroom/tax-law/b/fatcacentral/archive/2013/02/15/fatca-and-switzerland-model-ii.aspx (last visited on November 4, 2014).

ⁱⁱ *Id.*

ⁱⁱⁱ *Id.*

^{iv} The FATCA Model 2 Intergovernmental Agreement, International Tax Advisory, Alston & Bird LLP, Dec. 15, 2012, available online at www.alston.com/files/publication/eb4b2a00-c3a5-469c-92f7-0fd5a3bf5e89/presentation/publicationattachment/0ebf9793-24e9-46c6-a551-1016be8efd7e/int%20tax%20adv%2012-12.pdf, at 1 (last visited on November 4, 2014).

^v William Byrnes and Robert Munro, FATCA and Switzerland: Model II, LexisNexis Guide to FATCA Compliance, Ch. 19, May 2013, available online at www.lexisnexis.com/legalnewsroom/tax-law/b/fatcacentral/archive/2013/02/15/fatca-and-switzerland-model-ii.aspx (last visited on November 4, 2014).

^{vi} The FATCA Model 2 Intergovernmental Agreement, International Tax Advisory, Alston & Bird LLP, Dec. 15, 2012, available online at www.alston.com/files/publication/eb4b2a00-c3a5-469c-92f7-0fd5a3bf5e89/presentation/publicationattachment/0ebf9793-24e9-46c6-a551-1016be8efd7e/int%20tax%20adv%2012-12.pdf, at 1 (last visited on November 4, 2014).

^{vii} Id. at 2.

^{viii} Id. at 1.

^{ix} Id.

^x William Byrnes and Robert Munro, FATCA and Switzerland: Model II, LexisNexis Guide to FATCA Compliance, Ch. 19, May 2013, available online at www.lexisnexis.com/legalnewsroom/tax-law/b/fatcacentral/archive/2013/02/15/fatca-and-switzerland-model-ii.aspx (last visited on November 4, 2014).

^{xi} The FATCA Model 2 Intergovernmental Agreement, International Tax Advisory, Alston & Bird LLP, Dec. 15, 2012, available online at www.alston.com/files/publication/eb4b2a00-c3a5-469c-92f7-0fd5a3bf5e89/presentation/publicationattachment/0ebf9793-24e9-46c6-a551-1016be8efd7e/int%20tax%20adv%2012-12.pdf, at 2 (last visited on November 4, 2014)..

^{xii} Id.

^{xiii} William Byrnes and Robert Munro, FATCA and Switzerland: Model II, LexisNexis Guide to FATCA Compliance, Ch. 19, May 2013, available online at www.lexisnexis.com/legalnewsroom/tax-law/b/fatcacentral/archive/2013/02/15/fatca-and-switzerland-model-ii.aspx (last visited on November 4, 2014).