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CONTENTS

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CONTENTS CONTINUED

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FATCA and Schedule UTP: Are these unilateral US actions doomed unless adopted by other countries?[1]

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Abstract

Since the last ATAX conference in April 2010, the US has unilaterally adopted two, very controversial transparency initiatives:

- FATCA - Imposes a 30% withholding tax on a foreign financial institution (FFI) that desires to access the US financial market unless the FFI agrees to report information about its US customers.

- Schedule UTP - Requires large corporations to disclose uncertain tax positions (UTPs) for which a tax reserve has been recorded in audited financial statements.

While a senior US government tax official, the author was heavily involved in developing both FATCA and Schedule UTP. The primary purpose of this article is to discuss certain of the global considerations of these two ground-breaking initiatives. For example: Does the US need multilateral action to accomplish its goals with respect to either FATCA or Schedule UTP, and if so, what form might such action take?

The paper concludes the following:

- The US likely needs multilateral action to successfully implement FATCA, but it does not for Schedule UTP.

- Foreign countries would benefit greatly from using the US's leverage to effectively force financial institutions to join a multilateral FATCA system. The US would benefit from reducing the number of viable investment options available to US tax cheats.

- A successful multilateral FATCA system could incorporate multiple design features. For example, it could accommodate both a reporting and withholding model. However, if this option is selected, a "punitive withholding model" should be adopted that has a relatively high tax rate and applies to both investment income and new money. The failure to apply withholding tax to new money is a major deficiency of the recent withholding agreements between Switzerland and the UK/Germany.

- Schedule UTP requires a corporation to link a tax reserve with a specific tax issue. If tax reserves are recorded on an aggregate basis, the link between a tax reserve and a specific tax issue may be more difficult to establish. This issue had been resolved by FIN 48 in US GAAP, but it still exists for IFRS. Fortunately, there is a solution.

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[1] This article is based on a paper prepared for the 10th International Conference on Tax Administration hosted by ATAX, Australian School of Business, Sydney, Australia (April 2012). The date of the article is February 23, 2012.

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1. INTRODUCTION

Since the last ATAX conference in April 2010, the US has unilaterally adopted two, very controversial transparency approaches:

- FATCA - Short for Foreign Account Taxpayer Compliance Act, FATCA generally imposes a 30% withholding tax on a foreign financial institution (FFI) that desires to access the US financial market unless the FFI agrees to report information about its US customers to the US tax authorities.

- Schedule UTP - Requires large corporations to disclose on their tax return uncertain tax positions (UTPs) for which a tax reserve has been recorded in audited financial statements.

These ground-breaking transparency initiatives were designed to improve compliance for taxpayers the IRS has historically had significant difficulty auditing. Both could have global implications.

The primary purpose of this article is to discuss certain of these global implications. For example: Does the US need multilateral action to accomplish its goals with respect to FATCA or Schedule UTP, and if so, what form might such action take? Will these unilateral transparency approaches spread to the rest of the world? A secondary purpose is to provide background on the two initiatives for those with limited prior experience.

The article is written for several audiences. The entire article should be of interest to students and academics. Global tax policy makers and other tax professionals may want to focus on the global considerations in Section 3, and specifically:

Section 3.1.3 - Discusses key design issues in a multilateral FATCA regime, including whether there should be a reporting, withholding, or some hybrid model. Although a global reporting model would clearly be preferable, a model that accommodates both is feasible – especially if needed to initially obtain global consensus. However, a withholding model would have to be carefully structured and should apply to new money, as well as investment income.

Section 3.2 - For countries considering whether they should adopt an approach similar to Schedule UTP, this section discusses issues tax administrators may want to consider.

2. BACKGROUND

This section is intended for those that want to understand the history and basics surrounding either FATCA or Schedule UTP. If you already have such background, or alternatively are short of time, you should advance directly to Section 3 that discusses the global considerations of each.

2.1 FATCA[3]

Although US taxpayers have been hiding income overseas for decades[4,] US tax authorities (IRS) historically have had little success pursuing such income; the primary reason being that foreign financial institutions (FFIs) reported little or no information to the IRS. Occasionally the IRS became aware of an offshore account[5,] but effectively US taxpayers were on the honor system. Given that over 33,000 US taxpayers submitted voluntary disclosures surrounding their offshore accounts since 2009, it would appear many US taxpayers have not been very honest.[6]

In order to understand why the US adopted FATCA one needs to go back to January 1, 2001; the effective date for implementation of the US's Qualified Intermediary (QI) system.

2.1.1 The Qualified Intermediary (QI) system[7]

Prior to 2001, foreign financial institutions (FFIs) generally did not (i) collect U.S. tax documentation with respect to either US or foreign taxpayers, (ii) file information returns with the IRS, or (iii) submit to IRS oversight. As a result, there were two major problems:

Foreign Taxpayers - US withholding agents (e.g., US banks) did not obtain adequate documentation from FFIs to document a reduced US withholding tax rate on payments to foreign customers. This was not surprising given the FFI had the customer relationship, and the FFI was not anxious to share the identity of its clients with a potential competitor (i.e., a US bank).

US Taxpayers - A US taxpayer could invest with a FFI and the FFI was not required to report anything to the IRS.

Because of these problems, the US unilaterally implemented a Qualified Intermediary (QI) system. The primary purpose of the QI system was to address the first problem (i.e., source country withholding on payments to foreigners). The QI system only partially addressed the second (i.e., residence country reporting for US customers). As will be described in Section 2.1.3, FACTA directly results from the QI system's failure to comprehensively address the US customer issue.

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[3] For substantially more background, see J. Richard (Dick) Harvey, Jr., Offshore Accounts: Insider's Summary of FATCA and Its Potential Future, forthcoming Villanova Law Review (Spring 2012), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1969123.

[4] For example, in a letter dated May 29, 1937 to President Franklin Roosevelt, then Secretary of the Treasury Henry Morganthau explains why tax collections are less than anticipated. In this letter, Secretary Morganthau describes offshore accounts held by US taxpayers as part of the problem.

[5] For example, through a whistleblower like a former business partner or former spouse

[6] See http://www.irs.gov/newsroom/article/0,,id=251240,00.html for IRS Commissioner Shulman's speech on Dec. 15, 2011.

[7] US Treas. Reg. 1.1441-1(e)(5).

In summary, the QI system requires QIs to identify their customers. If they are foreign customers, the QI can keep the identity of their customer secret as long as the correct amount of US withholding tax is imposed on any US source payments. For US customers, the QI is only required to report US source income to the IRS. Foreign source income earned by a US customer is not reported.

It is important to note that the QI system was a major advancement when compared to the pre-2001 world, especially with respect to determining the correct amount of withholding tax to be applied on payments to foreigners. However, as time passed, it became very apparent that the QI system was not preventing US taxpayers from using offshore accounts to avoid US tax.

2.1.2 Major Issues with the Qualified Intermediary (QI) system

Although the QI system did include some reporting to the IRS with respect to US taxpayers, there were several major loopholes that were exploited by US taxpayers, their advisors, and foreign financial institutions (FFIs). For example:

- Foreign Source Income Not Reported - QIs were only required to report the US source income of their US customers. Since foreign source income was not reported, US taxpayers invested in foreign source assets to avoid reporting.
- No Requirement to Determine the Beneficial Owner - QIs were not specifically required to look-through foreign shell entities to determine whether a US customer was a beneficial owner. Thus, if a US taxpayer wanted to invest in US source assets and avoid reporting, it could establish a foreign shell entity and argue the entity was the beneficial owner of the income.
- QI Could Represent Only a Portion of the Worldwide Accounts – Since the primary emphasis of the QI system was to make sure the proper withholding tax was imposed on payments to foreigners, the QI system allowed foreign financial institutions to designate those accounts that were part of the QI system. This was done to avoid the QI having to perform detailed due diligence procedures on its entire customer base, especially those that never invested in the US.[8] The result was that a QI could exclude certain customers from the QI system, especially so-called “undeclared accounts”.[9]
- QIs Were Primarily Banks – Given the QI system was primarily aimed at custodial relationships, QIs were usually banks or trust companies. If a US taxpayer wanted to avoid any possibility of US reporting, they could invest in (i) a foreign mutual fund or private equity fund treated as a corporation for US tax purposes, or (ii) any other FFI that was not a QI.

[8] In most foreign financial institutions, the percentage of the customer base that invested in US source assets was very small. Although I am not aware of any statistics, it could be less than 1% in many cases.

[9] These are accounts were the customer refused to identify themselves.

- QI Audits – The QI audit was not really an audit, but rather was a list of procedures that needed to be performed. The procedures did not include any requirement for a QI auditor to look for, or report fraud. More importantly, the focus of the audit was on reviewing non-US customer accounts within the QI system, and not testing to determine whether US taxpayers were avoiding reporting by either (i) investing in foreign source assets, or (ii) holding US source assets in a foreign shell entity.

As will be described in Section 2.1.3, these loopholes were front and center on the minds of IRS, Treasury, and Congressional staff as they proposed and drafted FATCA in 2009 and 2010.

2.1.3 FATCA is conceived

Given the loopholes and issues surrounding the Qualified Intermediary (QI) system, there was general agreement among senior US government officials that something had to be done. The question became: What specific changes should be made to the QI system to make it more effective at preventing US taxpayers from hiding income offshore? The obvious answer was to attempt to address the problems identified in Section 2.1.2, and hence it was decided that QIs should be required to:

- Report both US and foreign source income for US taxpayers
- Determine if US taxpayers are the beneficial owners of foreign shell entities
- Review all customer accounts within the affiliated group to identify US taxpayers.

Thus, the concept of FATCA was born. However, as the US started down this path, several issues arose, including:

- Would US Taxpayers switch their Investments from QIs to other financial institutions (e.g., mutual funds, private equity, and insurance companies) – Since the QI system was a "carrot" primarily utilized by custodial and private banks, the QI system practically did not include many other foreign financial institutions (FFIs). There was significant concern that if the US made it difficult for US taxpayers to hide money offshore in bank and trust companies, many US taxpayers would start hiding their money in other offshore vehicles (e.g., various funds). Therefore, any proposal needed to either (i) expand the QI regime to include substantially all foreign financial intermediaries, or (ii) adopt some other approach to reduce the opportunities of US "tax cheats"[10] to invest with non-QIs (NQIs).

- Would QIs Abandon the QI System? – The QI system was designed to encourage FFIs to become QIs so they could avoid disclosing their customer's identity to potential competitors (e.g., US banks). Given the QI system utilized this carrot approach, there was significant concern that many QIs would abandon the system if they were now required to perform substantial

[10] Used throughout the article to refer to taxpayers that use, or want to use, offshore accounts to evade their residence country tax obligations.

additional burdens, including: (i) report both US and foreign source income for US taxpayers, (ii) determine the true beneficial owner of a shell entity, and (iii) perform customer due diligence on their entire customer base (including affiliates) to identify potential US customers.

As a result of the above issues, it was decided the new and improved QI system needed a penalty for FFI's that failed to participate. The penalty adopted was the imposition of withholding tax on US source payments (both income and gross proceeds) to a NQI.

In addition to the concerns that led to the introduction of a 30% withholding tax on NQIs, two others are worthy of note:

- Recalcitrant customers - As originally proposed, FATCA required QIs to close accounts for customers that refused to provide certain information. Given local country restrictions surrounding the closing of pre-existing accounts, FATCA was ultimately modified to allow these so-called "recalcitrant customers". However, QIs are required to report aggregate information to the IRS with respect to recalcitrant customers, and it was recognized that future multilateral discussions between governments may be needed to address the issue.

- Customer due diligence surrounding QI affiliates – The typical FFI has many legal entities around the world. If any part of such financial institution desired to be a QI, the US ideally needed to make sure all the legal entities around the world were performing adequate customer due diligence to identify US customers. Unfortunately, there are practical issues with requiring a global financial institution to identify US customers throughout its entire customer base.[11]

  It was ultimately decided the US Treasury would have authority to address this issue after FATCA was enacted. Again, this issue was recognized by some drafters as another reason for potential multilateral discussions. Specifically, it would be a lot easier for a FFI to perform detailed due diligence on its entire worldwide customer base (including affiliates) if such due diligence was required by more countries than just the US.

2.1.4 FATCA is enacted

Legislation was ultimately introduced in October 2009,[12] modified again in December 2009,[13] and finally enacted in March 2010 as part of the Hire Act[14]. Given the known

[11] For example, assume a FFI has millions of customers, but less than 1% are US customers. In such a situation, it is difficult to force the FFI to perform detailed customer due diligence on its entire customer base (including affiliates) to find a relatively small number of US customers.

[12] See H.R. 3933 and S. 1934, and Technical Explanation of the Foreign Account Tax Compliance Act of 2009, prepared by the Staff of the Joint Committee on Taxation, October 27, 2009 (JCX-42-09).

[13] See H.R. 4213 and the Technical Explanation of H.R. 4213, The Tax Extenders Act of 2009, prepared by the Staff of the Joint Committee on Taxation, December 8, 2009 (JCX-60-09).

[14] See P.L. 111-47, sections 501-535 and Technical Explanation of the Revenue Provisions Contained in … the Hiring Incentives to Restore Employment Act, prepared by the Staff of the Joint Committee on

problems with the QI system, the core FATCA provisions were not a surprise. FATCA requires participating foreign financial institutions (P-FFIs) [15] to:

- Report both US and foreign source income for US taxpayers,
- Determine whether US taxpayers are the beneficial owners of foreign shell entities, and
- Potentially perform detailed due diligence on all customer accounts within an affiliated group of companies to identify US taxpayers.

If a FFI does not become a participating P-FFI, it is subject to a 30% withholding tax on payments of both US source income and gross proceeds it receives on its own behalf, or on behalf of customers. This was primarily designed to encourage FFIs to become P-FFIs and be part of the FATCA system. It should also be noted that FATCA has the practical effect of extending the QI regime to a much broader group of foreign financial intermediaries, including offshore funds. In 2008, it was estimated there were approximately 5,600 QIs. [16] The number of FFIs ultimately impacted by FATCA is likely into the hundreds of thousands.

Finally, when FATCA was being designed, there was a clear understanding that it would not unilaterally eliminate all opportunities for a US taxpayer to hide income offshore. For example, a US tax cheat could invest in non-US source assets with a Nonparticipating FFI (NP-FFI) and avoid reporting to the IRS. However, the hope was that substantially all reputable FFIs would become P-FFIs. If this occurred, US tax cheats would be relegated to 2nd or 3rd tier foreign financial institutions that could cause the US tax cheat to question whether they really wanted to invest with such institution.

In summary, FATCA was enacted to address the deficiencies in the existing QI system with respect to (i) the identification of US customers, and (ii) US customer's investments in non-US source assets. However, as FATCA was being conceived and enacted, it was clear to some that in order for FATCA to be a success, multilateral action was likely to be needed. Specific concerns included: (i) local country restrictions on closing accounts and/or reporting information to the US; (ii) the need to have P-FFIs perform detailed due diligence on their entire customer base, including affiliates; and (iii) the need to narrow the investment options available to potential US tax cheats. See Section 3.1 for additional discussion of these concerns and how multilateral action could address them.

Taxation, February 23, 2010 (JCX-4-10). Although FATCA technically includes sections 501-535, section 501 is the subject of this article.

[15] FACTA uses the term "P-FFI", rather than QI. In addition, technically the US is maintaining its QI system, but it is possible the QI and P-FFI systems may ultimately be merged.

[16] See IRS Commissioner Shulman's testimony to Permanent Subcommittee of Investigations, US Senate, on July 18, 2008. Available at http://www.hsgac.senate.gov/subcommittees/investigations/hearings/tax-haven-banks-and-u-s-tax-compliance.

2.2 Schedule UTP [17]

A former IRS commissioner has called Schedule UTP the biggest change in US corporate tax administration in the last 50 years.[18] Others have made less flattering comments, but most everyone working in the US corporate tax community would admit it has been a big deal and will have a material impact on the way the IRS and large corporations approach audits in the future.

The obvious question is whether other tax administrators will consider adopting IRS Schedule UTP, or some variation, for their own purposes. Clearly the Australian tax authorities are, and one expects that ultimately other tax administrators may as well. This Section briefly discusses why Schedule UTP was adopted (Section 2.2.1), and the major concepts of Schedule UTP (Section 2.2.2).

2.2.1 Reason for adoption

Like most decisions, there were many factors. However, from my vantage point as one of the main architects of Schedule UTP, the ones below were most important:

- Tax audits of large corporations are inefficient and often times ineffective - The IRS has estimated that it spends approximately 25% of its time in corporate audits identifying issues.[19] Furthermore, in many cases the IRS does not identify all the major issues. Schedule UTP is intended to more quickly identify issues and hopefully minimize situations where major issues are not discovered.

- Favorable experience with Compliance Assurance Program (CAP) program - Since 2005, the IRS has administered the voluntary CAP program which promises quicker audits in exchange for increased transparency by corporations.[20] The IRS believed the CAP program was successful, but the program (i) required a significant commitment of IRS resources, and (ii) needed corporations to voluntarily participate. Thus, Schedule UTP is a way of improving transparency for thousands of large corporations without (i) the need for corporations voluntarily agreeing to participate, and (ii) a massive commitment of IRS resources to the labor intensive CAP program.

- FIN 48 was adopted[21] - Schedule UTP requires corporations to disclose tax issues for which a reserve was recorded in audited financial statements. Prior

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[17] For a very comprehensive discussion of the background surrounding schedule UTP, see J. Richard (Dick) Harvey,Jr., Schedule UTP: An Insider's Summary of the Background, Key Concepts, and Major Issues, DePaul Business and Commerce Law Journal (Spring 2008) also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1782951.

[18] Mary Lou Fahey, Transparency, Trust, and TEI, 61 Tax Executive 369, 370 (2010), and also direct discussion by the author with former Commissioner Lawrence Gibbs, now with Miller Chevalier

[19] See IRS Commissioner Shulman speech to New York State Bar Association on Jan. 26, 2010 announcing Schedule UTP concept. Speech available at http://www.irs.gov/newsroom/article/0,,id=218705,00.html

[20] As of February 2012 there are approximately 150 taxpayers in the CAP program.

[21] Issued by the Financial Accounting Standards Board in June 2006 and subsequently incorporated into ASC 740.

to FIN 48, it was possible for a business preparing its audited financial statements under US Generally Accepted Accounting Principles to record so-called "aggregate tax reserves" (i.e., one reserve covering a number of issues, or possibly even an entire tax year or audit cycle). Given FIN 48 requires the tax reserve analysis to be done on an issue by issue basis, its adoption in 2006 made it easier to establish a one-to-one relationship between a tax reserve and a tax issue and thus helped pave the way for Schedule UTP.[22]

- Litigation surrounding Tax Accrual Workpapers (TAWs) - Although the composition of TAWs varies from case to case, they generally include both (i) a description of each of the taxpayer's material tax issues, and (ii) the tax reserve recorded for each issue. In some cases, TAWs may also include tax opinions/memorandums.

  Based on various court cases,[23] some believed the IRS was entitled to a business's complete set of TAWs. Others, usually corporations and their tax advisors, did not agree with this conclusion. When combined with Announcement 2010-76, the issuance of Schedule UTP could be viewed as a compromise whereby the IRS generally agrees to forgo the pursuit of tax reserves and tax opinions in exchange for a description of the tax issue.[24]

Given the above background, the IRS made a decision to pursue Schedule UTP. The decision primarily resulted from the IRS's need to improve the efficiency and effectiveness of all large, corporate audits by obtaining enhanced transparency. In addition, the IRS was having favorable experiences with the CAP program, but expansion of that program to all large, corporations was not practicable.

For some, the decision to pursue Schedule UTP coupled with Announcement 2010-76 may also have been partially motivated by a desire to reduce the tension surrounding TAWs.[25] Finally, rather than attempting to develop a new standard for disclosure, the issuance of FIN 48 allowed the IRS to leverage the work done by corporations when preparing their audited financial statements.

2.2.2 Major concepts

The two major concepts surrounding Schedule UTP are:

Seehttp://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175822209924&blobheader=application%2Fpdf.

[22] See Section 3.2.2 for a discussion of IFRS and the potential for aggregate reserves.

[23] For example: Arthur Young, 465 U.S. 805 (1984) and United States v. Textron, Inc., 560 F.3d 513 (1st Cir. August 2009). However, these were specific taxpayer cases, as opposed to a broad based request to all large corporations to provide TAWs.

[24] See IRS Announcement 2010-76, 2010-41 I.R.B. 432 (Sept. 24, 2010) that further enhanced the IRS's policy of restraint by stating the IRS would not pursue TAWs that are "otherwise privileged", but for disclosure to the taxpayer's external auditor. Nevertheless, the IRS still has the ability to pursue tax reserves and tax opinions in certain cases (e.g., when there is a listed transaction or the documents are not "otherwise privileged").

[25] The effort to reduce tension may have been partially successful. Per a quote attributed to Eli Dicker, Tax Counsel for Tax Executives Institute, "at least the temperature has been dialed down a bit". See Jerimiah coder, UTP Guidance A High Priority, Wilkins Says, 129 Tax Notes 165 (Nov. 11, 2010).

- Criteria for disclosure - Large corporations are required to disclose a concise description on their tax return of tax positions for which they have either (i) recorded a reserve in audited financial statements; or (ii) not recorded a reserve and in reaching this conclusion it was assumed there was a greater than 50% probability of litigation (so-called “expect-to-litigate” provision). Thus, the criteria for Schedule UTP disclosure piggy-back’s on decisions made in the audited financial statements.

  The expect-to-litigate provision was included because it is possible to avoid recording a reserve under FIN 48 in cases where the taxpayer expects litigation, but believes it has a greater than 50% probability of winning such litigation. Given the corporation is expecting litigation, the IRS concluded the issue must be contentious and therefore disclosure is appropriate.

- Concise description - A concise description is defined as a “description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue”.[26] It is generally expected the description will be approximately 2-5 sentences long.

  The preliminary instructions to Schedule UTP also required disclosure of “the rationale for the position and the reason for determining the position are uncertain”. Several commentators questioned whether such disclosure is needed and suggested it could possibly violate a corporation’s privilege and work product protection. [27] In reaction to these comments, the IRS modified the instructions to remove the questioned language.

Other noteworthy Schedule UTP concepts include requirements to (i) identify tax positions that comprise more than 10% of the aggregate tax reserve for issues disclosed on Schedule UTP (i.e., so-called “major tax positions”), (ii) rank reserves from the largest to the smallest, and (iii) disclose whether the tax position is attributable to a permanent or temporary difference.

3. GLOBAL IMPLICATIONS

This section discusses selected global implications of FATCA and Schedule UTP. For example: Does the US need multilateral action to accomplish its goals with respect to either FATCA or Schedule UTP, and if so, what form might such action take? Will these unilateral transparency approaches adopted by the US spread to the rest of the world?

In summary, FATCA likely requires multilateral action to be successful, but it is far from clear whether such action will occur. In the case of Schedule UTP, multilateral action is not needed, but it is entirely possible several other countries might adopt the

[26] See 2011 Schedule UTP instructions, Part III at http://www.irs.gov/pub/irs-pdf/i1120utp.pdf.
[27] For example, see Tax Executives Institute comments at 2010 TNT 104-67 (May 28, 2010) and American Bar Association comments at 2010 TNT 104-66 (May 28, 2010).

principles of Schedule UTP. Thus, like many things in life, when you don't need something it is often easier to obtain; but when you do need it (e.g., FATCA), it can be very difficult. Fortunately, a multilateral FATCA system can be designed to accommodate different approaches, and therefore there is hope countries can agree on creating such a system.

3.1 Foreign Account Tax Compliance Act (FATCA)

Since FATCA was a bold, unilateral action by the US impacting global financial institutions and capital flows, there are many potential global implications. This Section 3.1 will discuss the potential need for multilateral cooperation among governments in order to (i) successfully implement FATCA within the US, and (ii) potentially extend FATCA to other countries around the world. Key design issues surrounding a multilateral FATCA regime will also be discussed in Section 3.1.3.

3.1.1 Key US implementations issues

Although there are many issues surrounding FATCA, the key issues surrounding the long-term success of FATCA from a US perspective are:

- Local country law restrictions on P-FFIs - These restrictions include laws that prevent foreign financial institutions (FFIs) from (i) closing existing customer accounts, and (ii) disclosing customer information to the IRS. The first issue was recognized as FATCA was being drafted and is what led to the "recalcitrant customer" provision in FATCA.[28] However, it was understood by some drafters that recalcitrant customers could not be allowed to exist indefinitely and a multilateral solution might be needed.

  The second issue was also recognized during drafting, but given that FFIs had previously figured out a way to report information to the IRS as part of the QI system, it was not presumed to be a serious problem. Rather, it was assumed US customers could waive their right to any sort of disclosure restrictions. Subsequent to the enactment of FATCA, this second issue has become a more serious concern.

- Assuring adequate customer due diligence is done by P-FFIs and their affiliates – As briefly discussed in Section 2.1.3, FATCA unilaterally attempts to force participating FFIs (P-FFIs) and their affiliates to perform detailed due diligence on their entire customer base. This has led some to ask: Is it fair, or practical, to request that a FFI with millions of customers perform detailed customer due diligence on its entire customer base (including affiliates) in order to discover a few US customers?

- Reducing investment options available to offshore US tax cheats – Given a dedicated US tax cheat can avoid FATCA by investing in non-US assets with

[28] Internal Revenue Code 1471(d)(6).

a NP-FFI, a key goal of the US tax authorities going forward should be to limit the investment opportunities for US tax cheats.

There are two key variables surrounding investment options for a US tax cheat: (i) the number and quality of financial institutions to invest with, and (ii) the range of non-US assets available to invest in. If ultimately US tax cheats are relegated to investing in very small, disreputable financial institutions or the assets available to invest in are severely limited, offshore tax evasion should be greatly reduced. If both occur,[29] offshore tax evasion should be effectively eliminated.

There are two basic approaches the US could use to address these key issues:

- Unilateral Action - The US could attempt unilateral adoption of FATCA with the hope the US investment market is sufficiently large that substantially all FFIs will need to become P-FFIs, and thus foreign governments will change local laws to accommodate FATCA's reporting obligation. Although this is possible, it is unlikely. For example, even if P-FFIs and their affiliates perform adequate due diligence, all a US tax cheat needs to do is find one reasonably reputable NP-FFI and invest in non-US assets with such NP-FFI. Given there are likely to be reasonably reputable FFIs that decide to be NP-FFIs, this is a real concern.

- Multilateral Action - Alternatively, the US could pursue multilateral action to help address the key issues. Multilateral action could take many forms, including:

    - Bilateral agreements to address local country restrictions on closing accounts and reporting information to the IRS

    - Bilateral, or multilateral agreements, surrounding uniform customer due diligence procedures

    - Full fledge multilateral system that comprehensively addresses all issues, including the narrowing of investment options for tax cheats.

  In order to obtain multilateral action, the US could work through the OECD, but such an effort could take many years to accomplish.[30] One alternative is for the US to approach other major countries individually about jointly addressing offshore accounts.

[29] Tax cheats are relegated to investing in very small, disreputable financial institutions, and the assets available to invest in are severely limited.
[30] For example, the OECD's Treaty Relief and Compliance Enhancement (TRACE) project started in 2006. See http://www.oecd.org/document/15/0,3746,en_2649_33747_45704847_1_1_1_1,00.html.

Based upon the joint statement by 6 countries (US, France, Germany, Italy, Spain, and the UK) on February 8, 2012[31], it appears the US has been approaching individual countries. At a minimum, the US is pursuing a solution to the various local law restrictions on P-FFIs reporting information directly to the IRS. However, based on the last sentence of the joint statement (i.e., section B.4.a) it appears the US's goals may be broader (i.e., a full fledge multilateral FATCA system). The last sentence states:

> "Commit to working with other FATCA partners, the OECD, and where appropriate the EU, on adapting FATCA in the medium term to a common model for automatic exchange of information, including the development of reporting and due diligence standards."

The remainder of the FATCA section of this article will assume the US and other countries are pursuing a broad global solution to the offshore account problem being faced by many "residence" countries, as opposed to just trying to work around various local country restrictions surrounding FATCA. Section 3.1.2 will discuss the potential benefits of a multilateral system, while Section 3.1.3 will focus on key design issues.

3.1.2 Benefits of a Multilateral FATCA system

Before discussing some of the key design issues surrounding a multilateral system, it may be helpful to explain the potential benefits of a multilateral FATCA system by illustrating what would happen if another country joined with the US in implementing FATCA as it is currently designed.[32]

Assume Country A decided to join the US in its FATCA system. In such case, the following would result:

- If a foreign financial institution (FFI) wanted to invest in either the US or Country A, it would need to execute an agreement with both the US and Country A.[33]

- The FFI and its affiliates would agree to identify both US and Country A customers and report information on such customers to the appropriate residence country (i.e., the US or Country A).

The US would obtain three principle benefits:

- First, since an FFI and its affiliates would need to perform detailed due diligence on its customer base to identify both US and Country A customers,

[31] For joint statement, see http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

[32] FACTA focuses on P-FFIs reporting directly to their customer's country of residence, and imposes a 30% withholding tax penalty on FFIs for not participating. See Section 3.1.3 for discussion of other design options.

[33] There could be one multilateral P-FFI agreement with both countries, or there could be separate bilateral agreements.

it would mitigate some of the criticism currently applicable to FATCA (i.e., a unilateral approach requiring FFIs to perform an unreasonable amount of due diligence to identify the proverbial needle in the haystack – a US customer).

- Second, for an FFI deciding whether to participate in FATCA, they would effectively have to make a decision to avoid the financial markets of both the US and Country A. This is obviously a tougher decision than just boycotting the US.

- And third, for a US tax cheat the investment opportunities would be reduced through a reduction in available (i) NP-FFIs, and (ii) asset classes (i.e., US and Country A assets would no longer be available).

Country A would also receive substantial benefits for joining with the US. Specifically, it could leverage the desire of financial institutions (FIs) to do business in the US. Said differently, if Country A tried to implement FATCA on its own, it is highly likely a substantial number of FIs would boycott Country A's stand-alone FATCA system. But if Country A joins-up with the US, it will be substantially more difficult for a FI to boycott both the US and Country A. Thus, even though the US would clearly benefit from Country A's participation, practically the potential benefits to Country A could be even greater.

Although it would be ideal if all countries in the world agreed to join the US's FATCA system, in reality, the US likely only needs several other major countries to participate in a multilateral FATCA regime to mitigate the major issues being raised with the US's unilateral adoption. Plus, as each additional country joins in a multilateral FATCA system, the number of investment opportunities available to a US tax cheat continue to dwindle (i.e., both NP-FFIs and asset classes are reduced).

3.1.3 Key design issues of a multilateral FATCA system

Assuming there is general agreement among participating countries surrounding customer due diligence procedures that include all affiliates of participating foreign financial institutions (P-FFIs), key design issues in structuring a multilateral system include:

- Should the system be based upon a reporting, withholding model, or hybrid model?

- Should P-FFIs report information directly to the customer's residence country, or report to the tax authorities of the source country who in turn would exchange information with the customer's country of residence?[34]

[34] Note the same conceptual question could also arise in a withholding model (i.e., should the P-FFI withhold and remit directly to the residence country, or first remit to the source country who in turn would remit to the residence country). This article assumes withholding, if applicable, will be routed through the source country to the residence country.

- Should countries or financial institutions be the focus of the system, and what is the appropriate penalty for not participating in the system?

Each of these design issues will be discussed below.

3.1.3.1 Reporting vs. withholding vs. hybrid model?

Before embarking on a discussion of the possibility of incorporating both a reporting model and a withholding model into a full fledge multilateral system, I want to make it explicitly clear that I have a very strong preference for a reporting model. I agree with the conclusion reached by Itai Grinberg in his recent paper[35] that a reporting model is clearly superior to a withholding model. However, I am also a realist and understand that recent tentative withholding agreements between Switzerland and the UK and Germany could make it difficult to implement a comprehensive global reporting model.[36] Thus, this discussion is intended to provide a potential alternative in the event a global reporting model is not possible.

Most tax authorities prefer a reporting model because it is substantially more difficult for a tax cheat to avoid paying taxes on both the principal deposited in an offshore account, and the investment income earned on the account.[37] Bank secrecy jurisdictions have a strong preference for a withholding model so as to protect the identity of their customers. The recent tentative withholding agreements involving Switzerland are examples of what can result from the tension between these opposing views.

Having reviewed the public information available on these two withholding agreements, my main objection to these agreements is that they do not adequately address the possibility of new money flowing into Swiss accounts in the future.[38] The agreements seem to assume that the only potential future tax evasion surrounds investment income on the existing account balance. It is entirely possible that a tax cheat could prospectively use a Swiss bank account to avoid tax on new money contributed to the account. This possibility appears to be a serious deficiency in these agreements and should be cause for major alarm by tax administrators around the world.

One possible response by global tax policy makers to this deficiency could be to not consider future withholding agreements and only pursue reporting agreements. If this is the result and a comprehensive multilateral reporting model can be adopted, I am all for it. However, if a comprehensive reporting model is not possible, an alternative is

[35] See working paper by Itai Grinberg, Beyond FATCA: An Evolutionary Moment for the International Tax System (January 27, 2012) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1996752.

[36] The German agreement was signed Sept. 21, 2011 and the UK agreement was signed Oct. 6, 2011. Both provide for the possibility of imposing withholding, rather than reporting, with respect to existing account balances. In addition, prospectively both only provide for withholding on certain income.

[37] In addition, transparency makes it more difficult for a tax cheat to claim non-tax benefits (e.g., social security or other welfare type payments based on income levels).

[38] This is somewhat surprising since the issue of tax evasion on the existing principal was addressed through the withholding agreement.

to allow certain countries (e.g., Switzerland) to prospectively participate in a multilateral FATCA arrangement if they agree to what I will refer to as a "punitive withholding model". The key design features of a punitive withholding model should include:

- Withholding on all future income and new money[39] - The imposition of withholding tax on new money is crucial to preventing tax cheats from using offshore accounts to avoid tax on the new money contributed to the account.[40] In addition, the definition of income should be relatively broad so tax cheats could not structure investments to avoid withholding.

- High Withholding Tax Rates - Rates should be equal to approximately the highest tax rate of tax in the customer's residence country. A decision would have to be made as to whether a P-FFI applied different withholding rates to different classes of income, or whether one high rate was applied to all income. Multiple classes of income could greatly complicate a P-FFI's withholding calculations because of the line drawing required. Thus, within a withholding model, it may be preferable to have one class of income for each residence country with a high tax rate.

- Opt out option - Because of the potential for over taxation, or even double taxation[41], a "punitive withholding model" should allow a customer to opt out of the withholding model into a reporting model on a customer by customer basis. One would expect that substantially all honest taxpayers would elect this option.

In summary, if necessary, a global hybrid FATCA system could be developed that allows certain bank secrecy countries to participate through a punitive withholding model, while other countries participated through a reporting model. Although not as optimal as a comprehensive reporting model, it could be a second best option.

If bank secrecy countries like Switzerland refuse to agree to a punitive withholding model as outlined above, it suggests they are clearly interested in continuing their efforts to assist tax cheats. In such case the rest of the world should aggressively pursue a global reporting model that severely penalizes countries and FIs for not participating. The end result is that such countries and FIs would hopefully become pariahs within the global financial system.

[39] It is assumed that any countries participating will have entered into a comprehensive withholding arrangement to address past deposits and investment income (i.e., similar to the UK and German agreements with Switzerland).
[40] In order to address the potential duplication of tax that could result from transfers of money between accounts, transfers within the country or from a country that is part of the multilateral FATCA system could be exempted from the withholding tax.
[41] For example, on transfers of amounts previously subject to tax.

3.1.3.2 Information flow in a reporting model?

Assuming a reporting model is adopted to some degree, one key question is whether reporting should be (i) direct from the P-FFI to the customer's residence country, or (ii) from the P-FFI to the source country that in turn exchanges the information with the customer's residence country. FATCA is designed to require the first alternative, while the TRACE project and the EU Savings Directive are designed to use the second.

In the abstract, I prefer the reporting model in FATCA because it eliminates the middleman and the possibility of more mistakes. However, given various issues surrounding local law, the alternative reporting model is acceptable and is the model the US appears to be pursuing with the 5 countries that it recently issued the joint statement surrounding FATCA.[42]

Despite the direction the US is heading with these 5 countries and possibly others, it is likely the US will not agree to FATCA information exchange agreements with all countries. In this case, it would appear FFIs located in countries that do not reach agreement with the US will either (i) agree to become a P-FFI and report directly to the US, or (ii) decide to not become a P-FFI. Presumably a similar scenario could develop in a full-fledge multilateral FATCA system whereby certain countries agree to participate, and others do not. In such case, a decision will need to be made whether individual FFIs in countries not participating, could still nevertheless participate in a multilateral system by agreeing to report directly to their customer's residence country. See Section 3.1.3.3 immediately below for additional discussion.

3.1.3.3 Should focus be on countries, FIs, or some combination?

FATCA focuses on financial institutions (FIs) rather than countries. Said differently, FATCA attempts to "blacklist" FIs for not participating, as opposed to blacklisting countries. When one first thinks about a multilateral FATCA system, one's knee jerk reaction is that the focus will need to shift from blacklisting FIs to blacklisting countries. However, this is not necessarily the case. It is still very possible for a group of countries to decide the focus should still be on participating FIs, as opposed to participating countries.[43]

Alternatively, one could envision a system where the focus is on both countries and FIs. In determining which focus to use, a key question will be: What to do about FIs located in countries that are not part of the global FATCA system? Will they be automatically excluded from the system and therefore subject to penalties, or will they be allowed to participate if they agree to provide information or withholding directly to residence countries?

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[42] Joint statement issued on February 8, 2012 by US, France, Germany, Italy, Spain, and UK. Supra, note 31.

[43] For example, see the Example in Section 3.1.2. This example effectively assumes a multilateral FATCA system where countries get together and blacklist FIs, rather than countries.

Another key question is whether a country participating in a multilateral FATCA system requires 100% participation from FIs located in the country. If the answer is "no", then it would seem a multilateral FATCA system would need to penalize non-participating FIs regardless of location.

In summary, because of the issues discussed above, it is not clear whether a multilateral FATCA system should penalize non-participating FIs, countries, or some hybrid. My suspicion is that in the early stages of a multilateral FATCA system it may need to be designed to penalize non-participating FIs, rather than all FIs in non-participating countries. The reason is that as a practical matter many countries may not have the ability to quickly join a multilateral FATCA system. Thus, for some transition period, one could imagine a system that allowed FIs in non-participating countries to join the multilateral FATCA system as long as they comply with the various customer due diligence and reporting obligations. However, after some suitable transition period, policy makers may want to effectively force all FIs within participating countries to join the system. Otherwise, there will always be NP-FIs willing and able to tailor their business to serve tax cheats.

3.1.3.4 Penalties to encourage participation?

Although I am tempted at this point in the article to suggest non-participants be forced to watch a year's worth of American reality TV shows as punishment, I will not. More realistic and appropriate penalties would include financial and/or operational penalties. When adopting FATCA, the US decided on a 30% withholding tax on payments to recalcitrant customers and NP-FFIs.

If there is a multilateral FATCA system, it would be helpful if the penalty for not participating was relatively uniform from country to country so as to avoid arbitrage opportunities. However, it is not crucial. Each country could determine its own penalty for not participating, but the key is making sure the penalty has significant teeth so as to encourage participation.

If enough countries participate in a multilateral FATCA system, it could be possible to totally blacklist a FI for not participating (i.e., wall the financial institution off from the rest of the world's financial system). Although this may be a utopian solution for some, as a practical matter we are not likely to see this solution for many years, if ever. Thus, financial penalties with teeth are likely to be what is focused on in the foreseeable future.

3.1.4 FATCA Summary

The US and foreign countries have made significant headway in the past several years addressing the use of offshore accounts to evade tax. The US has benefited from whistleblowers and two very successful offshore voluntary compliance initiatives. Other countries have also benefited from whistleblowers and voluntary compliance initiatives.

FATCA was enacted to help give the IRS the long-term tools necessary to better combat offshore tax evasion by US taxpayers, as opposed to relying on whistleblowers and voluntary compliance initiatives. However, since FATCA is a unilateral action by the US, there are several major implementation issues surrounding FATCA, including how to (i) address conflicts between FATCA and various country's laws (e.g., restrictions on closing accounts and reporting customer information), (ii) require detailed customer due diligence procedures for a FFI and its affiliates, and (iii) minimize the offshore investment options for US tax cheats.

In the long-run, the US could greatly increase the probability of FATCA's success by continuing discussions with other major countries. The recent joint announcement[44] by the US and 5 countries is a step in the right direction, but much needs to be accomplished. The goal of such discussions should at a minimum be to agree on (i) solutions to address the local law issues, and (ii) common customer due diligence procedures. However, if FATCA is really going to be successful, other countries may need to join the US in administering a multilateral FATCA type system. Foreign countries would benefit greatly from using the US's leverage to effectively force FFIs to join the system. The US would benefit from reducing the number of investment options available to US tax cheats.

There are several key design features of a multilateral FATCA system that need to be addressed, including: (i) a reporting vs. withholding vs. hybrid model, (ii) information flow under a reporting model, (iii) whether penalties are imposed on countries or nonparticipating financial institutions, and (iv) the nature of any penalties. Fortunately, a successful multilateral FATCA system could incorporate multiple design features. For example, a system could be designed that primarily uses a reporting model, but accommodates a withholding model for certain countries very sensitive to bank secrecy issues. This article argues that if a hybrid model is selected, it should include a "punitive withholding model" designed to apply to both new money and investment income with such amounts being subject to a relatively high tax rate.

3.2 Schedule UTP

When considering the global implications of Schedule UTP, there are several topics to consider, including:

- Will other tax administrators (e.g., non-US countries) be interested in adopting some form of Schedule UTP?
- Is Schedule UTP compatible with International Financial Reporting Standards (IFRS)? [45]
- Is a successful US adoption of Schedule UTP dependent to any significant extent on obtaining multilateral cooperation?

In short, the answers to these questions are "yes"; "yes, but … "; and "not really". The following sections will discuss these topics in more detail.

[44] Supra, note 31.
[45] IFRS are issued by the International Accounting Standards Board (IASB). See www.ifrs.org.

3.2.1 Will other tax administrators adopt some form of Schedule UTP?[46]

Given Australia is already well on its way to adopting its own version of Schedule UTP (referred to as Schedule RTP),[47] and certain state tax administrators in the US are also considering their options,[48] it seems the answer is clearly "yes". However, there are impediments that tax administrators need to consider, including:

- Is Schedule UTP compatible with IFRS? – see the discussion below in Section 3.2.2.

- Privilege and work product concerns - When considering Schedule UTP the IRS was very mindful of US law surrounding privilege and work product protections. As a result, the IRS decided to only require corporations to disclose a concise description[49] of an uncertain tax position, even though certain court cases gave the IRS access to even more sensitive taxpayer information.[50] For example, the IRS did not request disclosure on Schedule UTP of either a corporation's (i) tax reserve for a specific issue, or (ii) related tax opinions or memoranda. In fact, concurrent with the finalization of Schedule UTP the IRS made it more difficult to obtain such information.[51]

  Given privilege and work product laws will obviously vary by jurisdiction, tax administrators should carefully consider how such laws might impact consideration of a Schedule UTP approach.

- Other transparency efforts - Various countries have embraced the notion of transparency. For example, a few countries have a voluntary code of conduct[52] or some other form of enhanced relationship with large corporate taxpayers. If a country is considering a Schedule UTP approach, it should consider how Schedule UTP might interact with other transparency efforts. In its Schedule RTP, Australia requires disclosure if any of three scenarios are

[46] For a comprehensive discussion of various issues US state tax administrators should evaluate when considering Schedule UTP, see J. Richard (Dick) Harvey, Jr., Should the States Piggyback on Federal Schedule UTP, State Tax Notes, Aug. 1, 2011, p. 327. Several of these issues also could be applicable to foreign tax administrators. Also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1903991.

[47] See http://www.ato.gov.au/content/00279408.htm.

[48] For example, California and Alabama at http://www.ftb.ca.gov/professionals/taxnews/2010/December/Article_13.shtml and http://www.alvarezandmarsal.com/en/global_services/tax/enewsletter/archives/DisplayEnewsletter.aspx?enewsletter_id=375, Question 11.

[49] Defined as: "description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue". Supra, note 26.

[50] For example: Arthur Young, 465 U.S. 805 (1984) and United States v. Textron, Inc., 560 F.3d 513 (1st Cir. August 2009). However, these were specific taxpayer cases, as opposed to a broad based request to all large corporations to provide sensitive information.

[51] See IRS Announcement 2010-76, 2010-41 I.R.B. 432 (Sept. 24, 2010).

[52] See A Framework for a Voluntary Code of Conduct for Banks and Revenue Bodies, issued by the OECD Forum of Tax Administration in conjunction with its Istanbul meeting on September 15, 16, 2010.

present. Only one of these scenarios relates to the recording of a reserve. It would appear Australia decided to integrate a Schedule UTP approach with other indicia that it would like taxpayers to disclose.

In summary, one would expect tax administrators to be very interested in a Schedule UTP approach because it has the potential to target issues more quickly, and identify issues that could possibly be missed in an audit. However, at a minimum, tax administrators need to consider the above two issues[53] before rushing in to adopt a Schedule UTP approach.

3.2.2. Is Schedule UTP compatible with IFRS?

The key design feature of Schedule UTP is that a corporation must disclose tax positions for which a reserve has been recorded. Thus, in order for Schedule UTP to be workable, there needs to be a way to link a reserve with a specific tax position.

Prior to FIN 48[54] there was a wide variation in practice under US Generally Accepted Accounting Principles with some businesses recording reserves in the aggregate, rather than building-up reserves on a position by position basis.[55] When tax reserves are recorded in the aggregate it could be more difficult to determine whether a tax reserve has been recorded for a specific tax position. As a result, the requirement in FIN 48 to analyze each tax position separately was a key factor in the IRS's decision to adopt Schedule UTP.

Although a very high percentage of corporations filing US tax returns prepare their audited financial statements using FIN 48, some do not - especially subsidiaries or branches of foreign corporations using IFRS. As the IRS was developing Schedule UTP it was aware that IFRS was "silent on how to treat any uncertainty relating to amounts submitted to the tax authorities".[56] The IRS was concerned some corporations using IFRS may record aggregate reserves and therefore argue Schedule UTP would be inapplicable. The IRS took some solace in the IFRS exposure draft issued by the IASB in March 2009 that would have moved IFRS significantly closer to FIN 48.[57] However, by the time the IRS announced Schedule UTP in January of 2010[58,] the IASB had effectively shelved its exposure draft, especially the portion with respect to tax reserves.[59]

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[53] For other issues, see Supra, note 46.

[54] Supra, note 21.

[55] Although the US SEC actively discouraged the recording of general reserves, the practice survived to some extent for public companies, and was even more prevalent for private companies that were not subject to SEC oversight.

[56] See paragraph BC 58 in Basis for Conclusions, IASB Exposure Draft ED/2009/2 (March 2009), available at http://www.ifrs.org/NR/rdonlyres/A119DC06-B150-49FF-B60B-88CD8ED5FB20/0/EDIncomeTaxesBC.pdf.

[57] See IASB Exposure Draft ED/2009/2 (March 2009), available at http://www.ifrs.org/NR/rdonlyres/8A6D0AC9-B6BE-4B87-BD02-B058B5F12148/0/EDIncomeTaxesStandard.pdf.

[58] See Announcement 2010-9, 2010-7 I.R.B. 408, and IRS Commissioner Shulman speech to New York State Bar Association on Jan. 26, 2010 at http://www.irs.gov/newsroom/article/0,,id=218705,00.html.

[59] The IASB decided to significantly narrow the scope of its income tax project and thus its consideration of tax reserves has effectively been delayed. See

Despite the IASB's inaction, the IRS decided to move forward with Schedule UTP because most corporations filing US tax returns use FIN 48; but it provided special rules for corporations recording reserves on an aggregate basis. The Schedule UTP instructions are less than clear, but generally instruct the corporation to apply a hypothetical FIN 48 unit of account.[60]

What are the implications of the above discussion for the US and other countries?

- US - If the US ultimately adopts IFRS and there is no requirement in IFRS to determine tax reserves on an issue by issue basis, the US will likely need to rethink Schedule UTP. It could (i) expand on the "hypothetical FIN 48" approach currently in the Schedule UTP instructions, (ii) evaluate whether US corporations using IFRS will really attempt to record aggregate tax reserves to avoid Schedule UTP (especially given the SEC's views about general reserves), and/or (iii) lobby the FASB/IASB to adopt guidance requiring reserves to be determined on an issue by issue basis. Alternatively, the US could determine to abandon Schedule UTP.

- Other countries - Given most of the rest of the world is already using IFRS, other countries will clearly need to face this aggregate reserve issue prior to adopting their version of Schedule UTP. My personal suspicion is that most businesses using IFRS currently record reserves on an issue by issue basis, but given the opportunity to avoid tax return disclosure, many businesses may be willing to change to an aggregate reserve approach.

The good news for non-US tax administrators is that aggregate reserves should not be fatal to a Schedule UTP approach. Countries could adopt a "hypothetical FIN 48" approach, but this would seem unlikely.[61] Rather, one could imagine a foreign country adopting broad language that states something like "if a reserve is in any way connected to a specific tax issue", such tax issue needs to be disclosed. Even though a corporation may record reserves on an aggregate basis, the reserve needs to be supported by the existence of various tax uncertainties. If an aggregate reserve is in anyway based on a particular issue, such broad language should necessitate disclosure.

In summary, if a country (either foreign or the US) wants to adopt Schedule UTP in an IFRS world, they need to focus on the aggregate reserve issue. Fortunately, it seems plausible that countries (both foreign and the US) could tweak the language in Schedule UTP to satisfactorily address the concern surrounding aggregate reserves. Nevertheless, it would be preferable if IFRS explicitly required that tax reserves be recorded on an issue by issue basis.

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http://www.ifrs.org/Current+Projects/IASB+Projects/Income+Taxes/Meeting+Summaries+and+Observer+Notes/IASB+November+2009.htm.

[60] See Schedule UTP instructions surrounding "Unit of account" on page 3 of the 2011 instructions. Available at http://www.irs.gov/pub/irs-pdf/i1120utp.pdf.

[61] It was a stretch for the IRS to require a hypothetical determination on a method of accounting not used by a taxpayer, but at least the method of accounting in question is a method used in the US. Given that FIN 48 is little used in the rest of the world, it would seem more difficult for another tax administrator to insist on such hypothetical calculation.

3.2.3. Does the US need multilateral cooperation to successfully adopt Schedule UTP?

As discussed in Section 3.1, multilateral cooperation is likely to be very important in successfully implementing FATCA. This is not the case for Schedule UTP. Schedule UTP is a disclosure regime only applicable to businesses filing US corporate tax returns, and is therefore relatively self-contained to the US.

Two areas where multilateral cooperation could be of some minor benefit are:

- IFRS – As discussed in Section 3.2.2, it would be helpful if IFRS required businesses to record tax reserves on an issue by issue basis, rather than leaving open the possibility of recording a reserve on an aggregate basis. To the extent various countries put pressure on the IASB to issue more specific guidance, it might help the Schedule UTP approach, but it is not crucial. Plus, it is far from clear how the IASB might react to such multilateral pressure.

- Reserves recorded by related parties - Schedule UTP has a special rule that requires disclosure of a tax position if a corporation, or a related party, records a reserve for such tax position. This special rule was aimed primarily at US subsidiaries of foreign corporations where tax reserves are sometimes recorded on the foreign parent, rather than the US subsidiary.

  Since the IRS was concerned the foreign parent may not share its tax reserve information with the US subsidiary, Schedule UTP provides that the US subsidiary may check a box indicating a related party (e.g., a foreign parent) has not shared its tax reserve information. This is a fact pattern where one could imagine the US may request assistance from a foreign tax administrator under information exchange agreements. Thus, some multilateral cooperation may be required.

In summary, although there is some minor multilateral action that might help the US successfully implement Schedule UTP, it is not crucial.

4. CONCLUSIONS

Although the US unilaterally adopted FATCA and Schedule UTP, both of these ground-breaking transparency initiatives are being studied by other country's tax administrators. For example, as of the date of this article,[62] the US and five countries have issued a joint announcement with respect to FATCA,[63] and Australia has announced it is adopting Schedule RTP that incorporates many of the concepts of Schedule UTP.[64]

[62] February 23, 2012.
[63] Released on February 8, 2012. Supra, note 31.
[64] Supra, note 47.

The primary purpose of this article was to answer the following questions:

- Does the US need multilateral action to accomplish its goals with respect to either FATCA or Schedule UTP?
- If so, what are the key issues that need to be addressed to obtain multilateral action?
- Will these unilateral transparency approaches adopted by the US spread to the rest of the world?

In summary, the US likely needs multilateral action to successfully implement FATCA, but it does not for Schedule UTP. The recent joint announcement by the US and 5 other countries with respect to FATCA is the first step towards multilateral action, but it is only the beginning. Specific issues the US needs to address in order to make FATCA a success include:

- Conflicts between FATCA and various country's laws (e.g., restrictions on closing accounts and reporting customer information),
- The need for common detailed customer due diligence procedures for financial institutions and their affiliates, and
- A further reduction in the offshore investment options for US tax cheats.

In the long-run, the US could greatly increase the probability of FATCA's success by continuing discussions with other major countries. The goal of such discussions should at a minimum be to agree on (i) solutions to address the local law issues, and (ii) common customer due diligence procedures. However, if FATCA is really going to be successful, other countries may need to join the US in administering a multilateral FATCA type system.

It is important to note that foreign countries would benefit greatly from using the US's leverage to effectively force financial institutions to join the system. The US would also benefit from reducing the number of investment options available to tax cheats. There are several key design features of a multilateral FATCA system that need to be addressed, including:

- Reporting vs. withholding vs. hybrid model
- Information flow under a reporting model
- Whether penalties are imposed on countries or nonparticipating financial institutions
- The nature of any penalties.

Fortunately, a successful multilateral FATCA system could incorporate multiple design features. For example, even though a comprehensive reporting model would clearly be preferable, a multilateral system could be designed that primarily uses a reporting model, but also accommodates a withholding model for certain countries very sensitive to bank secrecy issues. This article concludes that if a withholding option is included, it should be a "punitive withholding model" and apply to both new money and investment income. The failure to apply withholding tax to new money is a major deficiency of the recent tentative withholding agreements between Switzerland and the UK/Germany.

Unlike FATCA, Schedule UTP does not require multilateral cooperation for successful adoption by the US or other countries. Nevertheless there are some global implications. The most notable is that Schedule UTP requires a corporation to link a tax reserve with a specific tax issue. If tax reserves are recorded on an aggregate basis (i.e., by groups of issues, or by tax year, or even by audit cycle), the link between a tax reserve and a specific tax issue may be more difficult to establish. This issue was resolved in US GAAP through the issuance of FIN 48/ASC 740. Nevertheless, the US may need to confront the issue again if it adopts IFRS and IFRS continues to have no requirement to record tax reserves on an issue by issue basis. Since most of the world uses IFRS, or is in the process of switching to IFRS, this aggregate reserve issue will also need to be addressed by non-US tax administrators considering a Schedule UTP approach.

In conclusion, FATCA and Schedule UTP are two unilateral US initiatives that have the potential to greatly increase transparency in two very difficult areas of tax administration: offshore accounts and complex corporate tax returns. The joint FATCA statement is a step in the right direction, and Australia has already adopted a version of Schedule UTP. However, there is much still to be done with multilateral cooperation potentially being crucial to FATCA's long-term success in the US. Other countries could substantially benefit from joining the US in a worldwide FATCA system.