

2015

The Foreign Account Tax Compliance Act (FATCA)

Elis Alberto Prendergast

Follow this and additional works at: https://scholarship.shu.edu/student_scholarship

Recommended Citation

Prendergast, Elis Alberto, "The Foreign Account Tax Compliance Act (FATCA)" (2015). *Law School Student Scholarship*. 683.
https://scholarship.shu.edu/student_scholarship/683

Contents

I. The Foreign Account Tax Compliance Act (FATCA)	2
A. <i>The United States Tax System</i>	2
B. <i>International Taxpayer Avoidance and Evasion</i>	4
C. <i>Qualified Intermediary Program: First attempt to combat U.S. tax evasion</i>	6
D. <i>Introduction of FATCA</i>	10
II. A Moral Critique of the Foreign Account Tax Compliance Act (FATCA).	17
A. <i>Natural Law Theories and Tax Evasion</i>	17
B. <i>Finnis' Basic Goods in relation to FATCA</i>	17
C. <i>Finnis' Requirements of Practical Reasonableness in relation to FATCA: The Nine Principles of Practical Reasonableness</i>	23

Overview

The first section of this article focuses on the enactment and implementation of the Foreign Account Tax Compliance Act (FATCA). Section one is divided into four sub sections. It begins with an introduction to the United States' system of taxation. It will then discuss the role "Tax Havens" play with respect to taxpayer noncompliance in our various tax regimes. Next, it covers the Qualified Intermediary program, which represents Internal Revenue Service's (IRS) first strike against international tax evasion. It will then cover the deficiencies with administering the Qualified Intermediary Program, which ultimately led to the enactment of FATCA.

The second section of this article will critique FATCA through John Finnis' theories of Natural Law and Natural Rights. Finnis' natural law theory is comprised of three equally important sections, " (i) a set of basic practical principles which indicate the basic forms of human flourishing as goods to be pursued and released, and which are in one way or another used by everyone who considers what to do however unsound his conclusion; (ii) a set of basic methodological requirements of practical reasonableness which distinguish sound from unsound practical thinking and which, when all brought to bear, provide the criteria for distinguishing acts that are reasonable, all things considered, an acts that are unreasonable, all things considered,, and (iii) a set of general moral standards. ¹ Accordingly, the second section of this article will focus on each of these points within natural law, as they relate to the enactment and implementation of the Foreign Account Tax Compliance Act.

¹ JOHN FINNIS, NATURAL LAW AND NATURAL RIGHTS (1980), page 23.

I. The Foreign Account Tax Compliance Act (FATCA)

FATCA comprises sections 1471-1474 of the Internal Revenue Code of 1986. It was enacted into law in 2010, by section 501(a) of the Hiring Incentives to Restore Employments (HIRE) Act. FATCA was passed to combat the perception that “each year, the United States loses an estimated \$100 billion in tax revenue due to offshore tax abuses.”² However, Congress projects that it will only receive \$8.714 billion in offset revenue for the ten year period between 2010 and 2020.³ Therefore, FATCA is not intended to completely eradicate tax evasion, as the United States may still lose an estimated \$99 billion per year.

A. The United States Tax System

The United States (U.S.) federal tax system inherits its power from the U.S. Constitution. Specifically, the Sixteenth Amendment to the U.S. Constitution, which was ratified by Congress on February 3, 1913. In that same year, the U.S. Revenue Act was signed into law. Throughout its more than 100 year existence, the U.S. tax system has developed into various regulatory regimes aimed at increasing the effectiveness of the identifying income subject to U.S. tax and increasing the collection of tax on these types of income. The collection of federal income tax is largely based on a system of “voluntary compliance.”⁴ The system of voluntary compliance places the onus of determining the appropriate amount of tax, and to pay such tax, on each taxpayer. The IRS monitors a taxpayer’s voluntary compliance, and develops the rules related to the assessment and payment of tax. When a taxpayer fails to comply with the rules governing the determination and collection of tax, the government may then involuntarily collect the

² Senate Permanent Subcommittee on Investigations, “Tax Havens Bank and U.S. Tax Compliance,” Staff Report, July 17, 2008.

³ Joint Committee on Tax, Estimated Revenue Effects Contained in Senate Amendment 3310, the “Hiring Incentives to Restore Employment Act,” under consideration by the Senate.

⁴ *Flora v. United States*, 362 U.S. 145, 176 (1960) (Court held that “our system of taxation is based upon voluntary assessment and payment)

appropriate amount from a deficient taxpayer.⁵ This system is innately adversarial, because most taxpayers want to pay the least amount of tax possible, while the government's goal is to maximize federal revenue.⁶

Generally, taxpayers that fail to comply with their tax obligations do so by either: (1) failing to file (non-filing), (2) underpaying their tax obligations (underpayment), or (3) underreporting the amount of tax owed (underreporting).⁷ The U.S. has confronted such taxpayer noncompliance by various means. Failing to file tax returns, may lead to the imposition of both civil and criminal penalties.⁸ Underpayment of tax has been tackled differently.⁹ Here, the U.S. sought to implement a system of withholding amounts for tax at source. Since it is believed that underpayment results from a failure to set aside sufficient funds, implementing a system of withholding at source reduces the likelihood of failure to pay because it removes the timespan from when a payment is received and when taxes are collected.¹⁰ The issue of underreporting has been handled with the implementation of information reporting regimes.¹¹

⁵ See Rev. Rul. 2007-20, 2007-14 I.R.B. 863. "Voluntary compliance" does not mean that paying income tax is optional. *Id.* Rather, the requirements of filing tax returns is well established in the Internal Revenue Code. I.R.C. §§ 6011(a), 6012(a), 6072(a) (2006); see also Treas. Reg § 1.6011-1(a) (1960). Tax consequences result from failing to meet these requirements. See, e.g., *United States v. Tedder*, 787 F.2d 540, 542 (10th Cir. 1986) (expounding that "although Treasury regulations establish voluntary compliance as the general method of income tax collection, Congress gave the Secretary of the Treasury the power to enforce the income tax laws through involuntary collection").

⁶ Jane G. Gravelle, Cong. Research Serv., R40623, *Tax havens: International Tax Avoidance and Evasion 1* (2010). Taxpayers minimizing their liability is tax "avoidance," not tax "evasion," and is encouraged. *Id.* Legally reducing the amount of tax owed is tax avoidance, as compared to tax evasion which uses illegal means to effect tax reductions.

⁷ Tax Gaps Facts and Figures, Internal Revenue Serv., at 1, www.irs.gov/pub/irs-utl/tax_gap_facts-figures.pdf

⁸ I.R.C. § 6651 (penalty computations for nonfiling), See also § 7203 (stating that failing to file a tax return (form), supply accurate information, or pay amounts due is a misdemeanor, punishable by fine and no more than one year imprisonment.)

⁹ Underpayment and underreporting are also subject to penalties once they are discovered, but additional mechanisms have been created to limit noncompliance. See *id.* § 6654 (penalties for failure to pay tax); *id.* § 6652 (penalties for failure to file certain information returns).

¹⁰ In House hearings it was determined that withholding at source was a way to get payment from those with little experience in setting aside moneys to meet their obligations. See Charlotte Twight, *Evolution of Federal Tax Withholding: The Machinery of Institutional Change*, 14 *Cato J.* 359, 370-371 (1995).

¹¹ See §§1-1441 (information returns required for payments made to foreign persons); § 6041 (information returns required for US persons)

These information reporting regimes require payors of income to report certain tax information to the taxpayers, as well as the IRS.¹² This allows the IRS to compare the amount of income reported by taxpayers against those reported by the payors of such income, thus creating a mechanism to identify taxpayers that fail to report correctly.

Accordingly, the U.S. federal income tax system relies solely on voluntary compliance by taxpayers, and third-party information reporting, in computing, reporting and remitting their tax liability each year.

B. International Taxpayer Avoidance and Evasion

U.S. persons have found ways to earn income and avoid being identified as owners of that income and therefore avoid disclosing income on their U.S. tax returns. When the IRS is not provided a Form 1099, reporting the income earned, there is a possibility that income earned by that U.S. person is not be detected if it is not reported voluntarily on their tax return. Thus, if that income is not reported, that person may have achieved a form of tax evasion.

Noncompliance has been a large problem in international taxation.¹³ Several reasons make offshore financial centers conducive for tax evasion.¹⁴ The main component for this is that tax policy may differ considerably among different countries.¹⁵ For example, some countries do not impose a tax on its citizens, while others impose a substantially low percentage rate.¹⁶ Moreover, bank secrecy laws differ among countries.¹⁷ This makes countries with bank secrecy laws even

¹² Id.

¹³ Melissa A. Dizdarevic, Comment: The FATCA Provisions of the HIRE ACT: Boldly Going Where No Withholding has gone before, 79 Fordham L.Rev. 2967, 2972 (2011).

¹⁴Id. (Citing Richard K. Gordon, on The Use and Abuse of Standards of Law: Global Governance and Offshore Financial Centers, 88 N.C. L.Rev. 501, 516 (2010).

¹⁵ Id.

¹⁶ Id.

¹⁷ Id. (citing Richard A. Gordon, Tax havens and their Use by United States Taxpayers.- An overview 15, 17 (1981)) Banking and secrecy laws are helpful to taxpayers that are seeking to avoid tax liability in their country of residence. This is because banks in countries with strict bank secrecy laws would not be required to hand over taxpayer information to foreign governments [here, the US]. Even under the circumstances where banks are required to hand

more attractive to tax evasion, because such laws generally safeguard the identification of account holders (purported U.S. taxpayer).¹⁸ Therefore, local country tax authorities cannot provide taxpayer information to the U.S. without violating local law.¹⁹ These countries are referred to as “Tax Havens” for this specific reason.²⁰ Hence, these countries are often used to evade tax. As an example, a taxpayer could open a bank account with a foreign bank and when the institution pays interest on the deposited funds, the interest income earned on such accounts will go untaxed by the U.S. and are not subject to reporting on information returns.²¹ Moreover, where the income goes unreported by the taxpayer on his U.S. tax return, the U.S. will not be aware of the additional income earned in the foreign bank account.²²

Tax Havens are not the only mechanism from which tax evasion can be established. Taxpayers may often create separate legal entities, and use these vehicles as a mechanism for shielding U.S. taxpayers.²³ Under the original withholding regime, U.S. tax law did not require offshore corporations to identify and disclose any U.S. ownership.²⁴ Therefore, corporations, including foreign corporations, were treated as taxpayers and the owners of their assets and income.²⁵ Thus, corporate structures allowed U.S. individuals to hide behind a foreign taxpayer.²⁶ Failing to disclose U.S. persons, coupled with the presence of bilateral treaties may

over such information, the information will be limited to information agreed upon in information exchange acts. Thus, taxing authorities in the US would have no way of knowing the existence of taxable income, or taxpayer identifying attributes. *Id.* at 516-518.

¹⁸*Id.* at 516 (Citing Gordon, *Supra* note 16)

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.* at 516-518.

²² *Id.*

²³ ²³ U.S. Gov’t Accountability Office, GAO-08-09, Tax Compliance: Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved 3 (2007)

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 26. Note that in contrast to U.S. tax law, U.S. securities regulation and other foreign money laundering and banking guidelines treat shareholders as the owners. Thus, U.S. persons would not be able to hide under foreign corporate structures. The existing regime was administered in such a way that even if withholding agents learn the

provide for circumstances in which U.S. persons would pay less tax to the U.S. as a foreign corporation, then they would have if the income was declared to be owned by the U.S. taxpayer.²⁷ Withholding agents did not have a requirement or mechanism to “look-through” foreign corporations in search for U.S. persons. Since the IRS regulations permit withholding agents to accept documentation declaring corporations’ ownership of income at face value, it may be possible for U.S. persons to establish a corporation offshore; submit a withholding certificate to the withholding agent(s) and receive a reduced rate of withholding, thus evading the imposition of U.S. taxation of some portions of the income earned by that offshore corporation.

28

C. Qualified Intermediary Program: First attempt to combat U.S. tax evasion

To combat the attractiveness tax evasion, the IRS developed a withholding system to tax non-resident aliens on certain types of income sourced within the U.S.²⁹ This system is known as Non-Resident Alien Withholding or Chapter 3 of the Internal Revenue Code.³⁰ Under this regime withholding agents that pay passive income, typically characterized as Fixed, Determinable, Annual, or Periodic (FDAP), derived from the United States are required to comply with certain rules concerning the identification of payees, tax withholding, and tax reporting associated with

identities of the owners of foreign corporations while carrying out their due diligence responsibilities (discussed supra); they did not have a responsibility to report that information to IRS. However, the rules did provide that in the presence of actual knowledge or reason to know that a claim for reduced withholding in the withholding certificate or other documentation is unreliable for purposes of establishing residency, new supporting documentation must be obtained.

²⁷ Id at 26. The presence of bilateral treaties between the U.S. and foreign jurisdictions may reduce or eliminate U.S. taxes on income that would otherwise be taxable to Non Resident Alien recipients, including foreign corporations, but generally not for U.S. persons. Similarly, the U.S. tax exemption for foreign recipients of portfolio interest, created to encourage foreign investors to purchase U.S. government and corporate debt, eliminates their tax on this type of income. The exemption is not available to U.S. persons, persons who own 10 percent or more of the debtor corporation or partnership, or persons failing to meet certain other restrictions.

²⁸ Id.

²⁹ I.R.C. §§ 1441-1443, 1445, 1446 (2006)

³⁰ Id.

such payments.³¹ A withholding agent that makes an in scope payment is responsible for withholding thirty percent tax from such payment and remitting that tax to the IRS.³² This tax collection mechanism seemed appropriate because the tax must by definition extend to a party outside U.S. jurisdiction. Without a system of withholding at the time of payment, enforcing taxes imposed on such types of income would be difficult to enforce because the purported taxpayer is not generally within the reach of the IRS.

The Qualified Intermediary (QI) program was initiated in 2000.³³ The program was established to enforce the regulations of sections 1441 and 1442 of the Internal Revenue Code. Under these sections, a person that makes a payment of certain passive income to a foreign person must generally deduct and withhold thirty percent from the payment.³⁴ However, a lower rate of withholding may apply for certain payments under the provisions of either the Internal Revenue Code, U.S. Treasury regulations, or an income tax treaty.³⁵ The program aimed to reduce tax evasion while balancing regulatory reporting burdens on financial institutions that handle foreign income payments by U.S. taxpayers.³⁶

Under the QI Program, foreign institutions voluntarily agreed to withhold and report the appropriate amount of U.S. tax they send to their offshore customers.³⁷ The program requires these institutions to subject themselves to U.S. laws and regulations related to payments made to U.S. persons. This includes, examining your client base to determine client types (e.g. U.S. v.

³¹ Under Treas. Reg. §§ 1441 and 1442, any foreign or domestic person having “control, receipt, custody, disposal, or payment” of any item of United States source income is a withholding agent for purposes of that payment.

³² United States International Taxation, 2nd Edition, Allison Christians, pg. 134

³³ U.S. Gov’t Accountability Office, GAO-08-09, Tax Compliance: Qualified Intermediary Program Provides Some Assurance That Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved 25 (2007)

³⁴ Internal Revenue Service, Rev. Proc. 2002-12, Application Procedures for Qualified Intermediary Status Under 1441; Final Qualified Intermediary Withholding Agreement.

³⁵ Id.

³⁶ I.R.S. Announcement 2000-48, 2000-4 I.R.B. 387, available at <http://www.irs.gov/pub/irs-drop/a-00-48.pdf>; See Also U.S. Gov’t Accountability Office, supra note 26 at 9-10.

³⁷ U.S. Gov’t Accountability Office, supra note 26 at 10

Non-U.S.) and the amount income paid to each type, determining whether clients are eligible for reductions in U.S. taxation, calculating the amount of withholding tax owed, remitting such tax to the U.S., and reporting appropriate amounts to IRS on Forms 1042.³⁸

As reward for undertaking these expansive responsibilities, QIs have the ability to retain the anonymity of their client list.³⁹ This is a competitive advantage to those who do not agree to voluntarily comply with the IRS' QI program. For instance, Non-Qualified Intermediaries (NQI), those who do not enter into an agreement with the IRS to perform the obligations discussed above, must reveal the identity of their clients to upstream withholding agents, or others in control of the payment to the customer, through additional documentation in order for their customers to receive treaty benefits.⁴⁰

³⁸ Id. When customers wish to claim treaty benefits or exemptions, they must also submit to a QI or other withholding agent an IRS Form W-8BEN, known as a withholding certificate, or other acceptable documentation. On the withholding certificate the customer provides various identifying information and completes applicable certifications, including that the customer is a resident of a country qualifying for treaty benefits or exemptions and that any limitations on benefits provisions in the treaty are met. The eligibility of treaty benefits is articulated in the relevant Tax Information Exchange Agreement (TIEA) between the foreign jurisdiction and the United States. For instance, the limitations on benefits provisions seek to prevent nonresidents of the two treaty countries from taking advantage of the preferential tax treatment in the favorable tax treaty by forming a conduit entity in the treaty country but then funneling the profits back (to the United States or another non-treaty country). Accordingly, the limitations on benefits provisions contained in many tax treaties between the United States and other countries disallow the availability of treaty benefits to recipients that do not maintain significant contacts with the treaty jurisdiction in question.

³⁹ Id.

⁴⁰ Id. at 11-12. Discussing that one of the principal incentives for foreign financial institutions to become QIs is their ability to retain the anonymity of their client list. QIs may report customer income and withholding information for a group of similar recipients receiving similar benefits, known as "pooled reporting." NQIs, on the other hand, must reveal the identity of their clients to upstream withholding agents through acceptable documentation in order for their customers to receive treaty benefits as well as interest and capital gains exemptions. Income owned by U.S. taxpayers held offshore may not be pooled and must be reported to IRS individually, either by the QI, NQI, or the last U.S. payor in a chain of payments. Payors of U.S. source income to U.S. taxpayers are not required to withhold from this income, but they must report the income on IRS Form 1099. U.S. taxpayers must report all of their current income on their income tax returns, including U.S. source and foreign source income, as well as ownership of foreign bank accounts and significant ownership in foreign corporations.¹² QIs may opt out of primary withholding and reporting responsibilities for designated accounts—including those owned by U.S. persons—ceding those responsibilities and liabilities to financial institutions upstream in the chain of payments. Eventually, the responsibilities and liabilities associated with these accounts may fall to the last payor within the United States (and therefore within the jurisdiction of IRS)."

Although the QI program seemed to be well received by withholding agents, as its goal of incentivizing banks to withhold and report accurate amounts was becoming realized, it did not remedy the abuses of the foreign privacy incentives and the persistence of the information gap.⁴¹

This program while effective, is not without its flaws. Taxpayer noncompliance was publicized in a recent case in where the United States charged the Union Bank of Switzerland (UBS) with conspiring to defraud the U.S. government. UBS was accused with participating in a scheme to defraud the United States, and specifically the IRS, by actively assisting or facilitating a member of U.S. individual taxpayers in establishing accounts at UBS in a manner designed to conceal the U.S. taxpayer's ownership in such accounts.⁴² The agreed upon facts concluded that private bankers and managers facilitated the creation of accounts in the names of offshore companies, thus allowing the U.S. taxpayers to evade the requirement of disclosing income earned from trade in securities or other financial transactions.⁴³ Moreover, the Court found that "these private bankers and managers would actively assist or otherwise facilitate certain undeclared United States taxpayers, who these private bankers and managers knew or should have known were evading United States taxes, by meeting with these clients in the United States and communicating with them via United States jurisdictional means on a regular and recurring basis with respect to their UBS undeclared accounts." Accordingly, the U.S. government required additional mechanisms to combat U.S. tax evasion.

⁴¹ Melissa A. Dizdarevic, Comment: The FATCA Provisions of the HIRE ACT: Boldly Going Where No Withholding has gone before, 79 Fordham L.Rev. 2967, 2980 (2011).

⁴² See generally UBS Case, Fed. Dep't Just. & Police (July 15, 2010) http://www.ejpd.admin.ch/ejpd/en/home/themen/wirtschaft/ref_fallubs.html (From 2000-2007, Union Bank of Switzerland (UBS) operated a cross-border banking business with U.S. clients. This business was comprised of about 60 private bankers located in several offices throughout Switzerland. The private bankers targeted and met with U.S. clients, in the United States. The private bankers serviced approximately 20,000 U.S. clients, with assets exceeding \$20 billion. Of its 20,000 U.S. clients, approximately 17,000 concealed their identities and ownership in accounts from the IRS. Moreover, many of these clients failed to pay tax to the IRS on income earned from these UBS Accounts, and UBS, as a withholding agent, failed to report to the IRS income earned on such accounts)

⁴³ Id.

In response to the problems of international tax evasion, Congress enacted FATCA, which is intended to combat the gaps left in taxation from the use of tax treaties and QI reporting requirements.⁴⁴ The statute and subsequent guidance issued by the U.S. Department of Treasury and the Internal Revenue Service has collectively been known as FATCA.⁴⁵

D. Introduction of FATCA

The FATCA provisions were enacted under President Obama's HIRE Act.⁴⁶ FATCA added Sections 1471 to 1474 of the Internal Revenue Code and was enacted with the intention of filling in the compliance gaps of the existing withholding regime.⁴⁷ ⁴⁸It does so by taking a more active approach towards information reporting by requiring withholding agents to increase detection procedures and creating a penal system of withholding for those that do not comply.⁴⁹

FATCA introduced a new reporting regime aimed at the disclosure of U.S. persons with offshore investments. This is accomplished by a new withholding regime that works in tandem

⁴⁴ See supra note 44 (Citing, Staff of J. Comm. On Taxation, 111th Cong., Description of Revenue Provisions Contained in the President's Fiscal Year 2011 Budget Proposal 206-306 (Comm. Print 2010), available at <http://www.jct.gov/publications.html?func=startdown&id=3704> (noting the various strategies by which international tax can be enforced); U.S. Dept. of Treasury, Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance 9-12 (200), available at http://www.irs.gov/pub/newsroom/tax_gap_report_final_version.pdf (explaining that the failing to report offshore income is the top priority of the Obama Administration, and that the comprehensive approach includes legislative proposals, improved bilateral agreements, and increased enforcement.)

⁴⁵ The FATCA provisions is a collection of several guidance issued by the Department of Treasury and the Internal Revenue Service. It includes: see generally Hiring Incentives to Restore Employment Act § 501 (the act), IRS Notice 2010-60, 2010-37 IRB 329 (providing preliminary guidance); IRS Notice 2011-34, 2011-19 IRB 765; IRS Notice 2011-53, 2011-19 IRB 775 (modifying Notice 2011-34 and providing timelines for implementation); IRS Announcement 2012-43 (amending timelines for due diligence procedures and discussing additional guidance concerning withholding on gross proceeds income); IRS Notice 2013-42 (revising timelines yet again, and discussing guidance concerning the treatment of financial institutions located in jurisdictions that have signed intergovernmental agreements for the implementation of FATCA but have yet to make such agreements effective); Notice 2013-43 (providing transitional rules concerning the implementation of FATCA timelines) This note will not distinguish between the provisions introduced in any of the guidance issued to date. This is because the provisions have changed throughout the issuance of the guidance, and the scope of this comment will not discuss the change each guidance has on the overall FATCA provisions. Lastly, the FATCA provisions discussed within this comment focus on the provisions imposed on foreign financial institutions, and not United States withholding agents.

⁴⁶ The provisions intended to increase disclosure of beneficial owners, were originally introduced in both houses of Congress in 2009. See generally Foreign Account Tax Compliance Act of 2009, S. 1934, 11th Cong.

⁴⁷ See 156 Cong. Rec. S1745; see also supra note 2.

⁴⁸

⁴⁹ Id.

with the current withholding regime. FATCA focuses primarily on gathering reporting from non-U.S. financial institutions (known in FATCA as foreign financial institutions, or FFIs). The reason for this focus is case history: It has frequently been found that U.S. tax evaders accomplish tax abuse by establishing entity accounts at FFIs making it less obvious that U.S. persons are owners of the accounts.⁵⁰ To help combat this tax abuse by U.S. persons, every FFI will need to classify its status under FATCA, and if required, enter into an agreement with the IRS to, among other things, identify U.S. persons and report them annually to the IRS. Chapter 4 imposes a penal withholding tax on withholdable payments made to FFIs and other foreign entities that fail to comply with the disclosure requirements.

The FATCA provisions allow foreign entities to decide among several mechanisms for compliance.⁵¹ Under FATCA, every foreign institution will need to determine its status under FATCA or appropriate IGA and, where required, enter into an FFI agreement with the IRS.

When the initial guidance was released, a handful of countries worked with Treasury to develop an alternative approach to FATCA that would not violate local privacy laws.⁵² These approaches became known as Intergovernmental Agreements (IGAs).⁵³ When a jurisdiction

⁵⁰ See supra note 45.

⁵¹ See supra note 44, at 2985 (discussing FATCA's strategic design)

⁵² Press Release, U.S. Dep't of Treasury, Joint Statement from the U.S., Fr., Ger., It., Spain and the U.K. Regarding an Intergovernmental Approach to Improving Int'l Tax Compliance and Implementing FATCA (Feb. 8, 2012), available at <http://www.treasury.gov/press-center/press-releases/documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf>.

⁵³ See Press Release, U.S. Dep't of Treasury, Treasury Releases Model Intergovernmental Agreement for Implementing the Foreign Account Tax Compliance Act to Improve Offshore Tax Compliance and Reduce Burden (July 26, 2012), <http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx>. Treasury revised the text of both versions of Treasury Model 1 on November 14, 2012, to reflect the texts of the negotiated IGAs. See U.S. Dep't of Treasury, Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA, available at <http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf> [hereinafter Treasury Model I]; see also U.S. Dep't of Treasury, Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA [hereinafter Treasury Model I Nonreciprocal Version], available at <http://www.treasury.gov/press-center/press-releases/Documents/nonreciprocal.pdf> [hereinafter Treasury Model I Nonreciprocal Version]. For the November 4, 2013 versions of these models, see, for example, Model 1A IGA Reciprocal, Preexisting TIEA or DTC, available at <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>.

enters into an IGA with Treasury, it acknowledges that the FFIs operating within its jurisdiction will perform the requisite account due diligence and reporting. The method for accomplishing these requirements are left to be implemented by local law.

Jurisdictions with a Model 1 IGA pass their own legislation that will govern the FFI's obligations under FATCA.⁵⁴ That Model 1 FFI will report substantially the same information as United States withholding agent, but will do so directly to its local government.⁵⁵ The benefit of entering into this agreement is that, a Model 1 FFI does not have withholding obligations with respect to individual accounts that have been properly reported. However, it must still provide withholding instructions relating to any withholdable payment allocable to an account that has failed to comply with FATCA's disclosure requirements.

In contrast, Jurisdictions that enter into a Model 2 IGA agree that there FFIs intend to follow the terms of an FFI Agreement as modified by the Model 2 FFI agreement.⁵⁶ Model 2 FFIs must report directly to the IRS and is obligated to withhold on withholdable payments made to noncompliant entities.⁵⁷

FATCA impacts many more non-U.S. entities than initially anticipated. This is due to the fact that the definition of a financial institution is extremely broad and includes entities well beyond those that fall within the traditional definition. Under FATCA, a financial institution includes an entity that: (1) Accepts deposits in the ordinary course of a banking or similar business⁵⁸; (2) Holds, as a substantial portion of its business, financial assets for the benefit of

⁵⁴ Id.

⁵⁵ Id.

⁵⁶ U.S. Dep't of Treasury, Model 2 Template, Agreement between the United States of America and [FATCA Partner] for Cooperation to Facilitate the Implementation of FATCA, available at <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>; see Model 2 Agreement, Preexisting TIEA or DTC (updated 11-4-2013) [hereinafter Treasury Model II].

⁵⁷ Id.

⁵⁸ See §1.1471-5(e)(2)(i)(F). In general, an entity is considered to be engaged in a banking or similar business if, in the ordinary course of its business with customers, the entity accepts deposits or other similar investments of funds

one or more other persons⁵⁹; (3) Is an investment entity⁶⁰; (4) Is an insurance company or a holding company that is a member of an expanded affiliated group that includes an insurance company, and the insurance company or holding company issues, or is obligated to make payments with respect to, a cash value insurance or annuity contract; or (5) Is an entity that is a holding company or treasury center is part of an expanded affiliated group that includes a

and regularly engages in one or more of the following activities- (A) Makes personal, mortgage, industrial, or other loans or provides other extensions of credit; (B) Purchases, sells, discounts, or negotiates accounts receivable, installment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness; (C) Issues letters of credit and negotiates drafts drawn thereunder; (D) Provides trust or fiduciary services; (E) Finances foreign exchange transactions; or (F) Enters into, purchases, or disposes of finance leases or leased assets.

⁵⁹ Id. Discussing, that in general, an entity holds financial assets for the account of others as a substantial portion of its business if the entity's gross income attributable to holding financial assets and related financial services equals or exceeds 20 percent of the entity's gross income during the shorter of- (1) The three-year period ending on December 31 of the year preceding the year in which the determination is made; or (2) The period during which the entity has been in existence before the determination is made. Income attributable to holding financial assets and related financial services includes custody, account maintenance, and transfer fees; commissions and fees earned from executing and pricing securities transactions; income earned from extending credit to customers with respect to financial assets held in custody by the entity (or acquired through such extension of credit); income earned on the bid-ask spread of financial assets; fees for providing financial advice with respect to financial assets held in (or potentially to be held in) custody by the entity; and fees for clearance and settlement services.

⁶⁰ Id. Discussing that the term investment entity means any entity that meets one of the following tests. (A) Thee entity that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer- (1) Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign currency; foreign exchange, interest rate, and index instruments; transferable securities; or commodity futures; (2) Individual or collective portfolio management; or (3) Otherwise investing, administering, or managing funds, money, or financial assets on behalf of other persons. An entity is treated as primarily conducting as a business one or more of the activities above if the entity's gross income attributable to such activities equals or exceeds 50 percent of the entity's gross income during the shorter of: (1) The three-year period ending on December 31 of the year preceding the year in which the determination is made; or (2) The period during which the entity has been in existence. (B) The entity's gross income is primarily attributable to investing, reinvesting, or trading in financial assets and the entity is managed by another entity that is a financial institution, other than a holding company or treasury center described in §1.1471-5(e)(1)(v). For purposes of this paragraph, the term financial asset means a security (as defined in section 475(c)(2) without regard to the last sentence thereof), partnership interest, commodity (as defined in section 475(e)(2)), notional principal contract (as defined in §1.446-3(c)), insurance contract or annuity contract, or any interest (including a futures or forward contract or option) in a security, partnership interest, commodity, notional principal contract, insurance contract, or annuity contract. Moreover, for purposes of this paragraph, an entity is managed by another entity if the managing entity performs, either directly or through another third-party service provider, any of the activities described in paragraph (e)(4)(i)(A) of this section on behalf of the managed entity. An entity's gross income is primarily attributable to investing, reinvesting, or trading in financial assets if the entity's gross income attributable to investing, reinvesting, or trading in financial assets equals or exceeds 50 percent of the entity's gross income during the shorter of: (1) The three-year period ending on December 31 of the year preceding the year in which the determination is made; or The period during which the entity has been in existence. (C) The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.

depository institution, custodial institution, specified insurance company, or investment entity or is formed in connection with or availed of by a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.⁶¹

A U.S. financial institution must focus its efforts on all payees to whom it makes a withholdable payment.⁶² For non-U.S. financial institutions, every account must be reviewed, whether or not it makes a withholdable payment.⁶³ In addition, any non-U.S. entity that doesn't fall within the definition of an FFI defaults to a nonfinancial foreign entity (NFFE).⁶⁴ These

⁶¹ An entity is a holding company if its primary activity consists of holding (directly or indirectly) all or part of the outstanding stock of one or more members of its expanded affiliated group. A partnership or any other noncorporate entity shall be treated as a holding company if substantially all the activities of such partnership (or other entity) consist of holding more than 50 percent of the voting power and value of the stock of one or more common parent corporation(s) of one or more expanded affiliated group(s). If a partnership or other non-corporate entity owns more than 50 percent of the voting power and value of the stock of more than one common parent corporation of an expanded affiliated group, each common parent corporation's expanded affiliated group will be treated as a separate expanded affiliated group for purposes of applying the rules of this section unless a non-corporate entity is treated as the common parent entity of the expanded affiliated group. An entity is a treasury center if the primary activity of such entity is to enter into investment, hedging, and financing transactions with or for members of its expanded affiliated group for purposes of: (i) Managing the risk of price changes or currency fluctuations with respect to property that is held or to be held by the expanded affiliated group (or any member thereof); (ii) Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to borrowings made or to be made by the expanded affiliated group (or any member thereof); (iii) Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to assets or liabilities to be reflected in financial statements of the expanded affiliated group (or any member thereof); (iv) Managing the working capital of the expanded affiliated group (or any member thereof) such as by pooling the cash balances of affiliates (including both positive and deficit cash balances) or by investing or trading in financial assets solely for the account and risk of such entity or any member of its expanded affiliated group; or (v) Acting as a financing vehicle for the expanded affiliated group (or any member thereof).

⁶² See Treas. Reg. § 1.1471-2(a)(1), 78 Fed. Reg. at 5911-12 (mandating 30 percent withholding of any "withholdable payment" unless statutorily excepted by an exemption)

⁶³ IRS Rev. Proc. 2014-33, Section III, (Discussing that Section 1471(b)(1)(A) and (B) requires an FFI that enters into an FFI agreement (a participating FFI) to identify its U.S. accounts and comply with verification and due diligence procedures prescribed by the Secretary.)

⁶⁴ See Treas. Reg. § 1.1471-4(f) (exempting from withholding under section 1471(a) certain payments beneficially owned by certain persons, including any foreign government, international organization, foreign central bank of issue, or any other class of persons identified by the Secretary as posing a low risk of tax evasion. Section 1472(a) requires a withholding agent to withhold 30 percent of any withholdable payment to an NFFE if the payment is beneficially owned by the NFFE or another NFFE, unless the requirements of section 1472(b) are met with respect to the beneficial owner of the payment. Section 1472(d) defines an NFFE as any foreign entity that is not a financial institution as defined in section 1471(d)(5).)

entities are also be significantly impacted as they will be required to certify their FATCA status to FFIs and USWAs with whom they transact business and, in certain cases, are required to disclose substantial U.S. owners.⁶⁵

FATCA relies upon proper documentation and identification of payees and account holders. Documentation, or lack thereof, can trigger withholding and reporting requirements. FATCA ultimately is about identifying U.S. persons and reporting information such as account balances and payments made to certain U.S. persons and certain U.S. owned foreign entities.⁶⁶ Payments made after July 1, 2014, are impacted by FATCA.⁶⁷ Reporting commences in 2015 for calendar year 2014.⁶⁸ Due to various delays, the IRS provided transitional relief, effectively delaying many of the requirements, including most withholding, until January 1, 2015.⁶⁹

For foreign entities, noncompliance will result in penal withholding tax on entities that refuse to identify and report U.S. persons. Essentially, putting non-participating organizations out of business in terms of investing into the U.S. market for either themselves or their clients/investors. Noncompliance for U.S. financial institutions results in liability for amounts that should have been withheld, as well as penalties and interest. In addition, for FFIs operating

⁶⁵ Id.

⁶⁶ See Supra Note 66.

⁶⁷ Supra Note 63.

⁶⁸ IRS Rev. Proc. 4014-33, Section III, (The final regulations modify the due date for the first information report by requiring participating FFIs to file the first information reports with respect to the 2013 and 2014 calendar years not later than March 31, 2015)

⁶⁹ IRS Rev. Proc. 2014-33, (The notice announced that calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration with respect to the implementation of FATCA by withholding agents, FFIs, and other entities with chapter 4 responsibilities, and with respect to certain related due diligence and withholding provisions under chapters 3 and 61, and section 3406, that were revised in regulations issued earlier that year. It also announced the intention of Treasury and the IRS to further amend the regulations under sections 1441, 1442, 1471, and 1472, as applicable, to provide that a withholding agent or FFI may treat an obligation (which includes an account) held by an entity that is opened, executed, or issued on or after July 1, 2014, and before January 1, 2015, as a preexisting obligation for purposes of sections 1471 and 1472, subject to certain modifications described in section IV of this notice...)

under an IGA, noncompliance will result in a violation under local law, which carries consequences that vary by jurisdiction.

II. A Moral Critique of the Foreign Account Tax Compliance Act (FATCA).

A. *Natural Law Theories and Tax Evasion*

Finnis' natural law theory is comprised of three equally important sections, “ (i) a set of basic practical principles which indicate the basic forms of human flourishing as goods to be pursued and released, and which are in one way or another used by everyone who considers what to do however unsound his conclusion; (ii) a set of basic methodological requirements of practical reasonableness which distinguish sound from unsound practical thinking and which, when all brought to bear, provide the criteria for distinguishing acts that are reasonable, all things considered, an acts that are unreasonable, all things considered,, and (iii) a set of general moral standards.⁷⁰ The remainder of this article will focus on each of these points within natural law, as they relate to the enactment and implementation of the Foreign Account Tax Compliance Act.

B. *Finnis' Basic Goods in relation to FATCA*

Finnis's Natural Law theory introduces seven basic goods, which are equally irreducible and self-evident.⁷¹ Each good is equally self-evident, each good cannot be “analytically reduced to being merely an aspect of any of the others,” and the seven goods are equally fundamental.⁷² Finnis theorizes that all reasonable people agree that these goods are objects of human striving, and present universally among cultures.⁷³ The seven basic goods may be thought of as an exhaustive list, since many other self-evident values can be categorized under the Finnis' seven basic goods.⁷⁴ These seven basic goods are: (i) life, (ii) knowledge, (iii) play, (iv) aesthetic experience); (v) sociability/friendship, (vi) practical reasonableness, and (vii) religion.⁷⁵

⁷⁰ JOHN FINNIS, *NATURAL LAW AND NATURAL RIGHTS* (1980), page 23.

⁷¹ *Id.* at 59.

⁷² *Id.* at 92.

⁷³ *Id.* at 81-84.

⁷⁴ *Id.* at 90.

⁷⁵ *Id.* at 86-89.

The basic forms of goods are things to be pursued by men, as they undergo practical reasoning.⁷⁶ They are values sought for their own sake.⁷⁷ Life includes “every aspect of the vitality, which puts a human being in good shape for self-determination.”⁷⁸ This includes physical and mental health.⁷⁹ The next basic good is knowledge that is desirable for its own sake, and not merely instrumental.⁸⁰ Play is “engaging in performances which have no point beyond the performance itself, enjoyed for its own sake.”⁸¹ Play can enter into any human activity, but it is always analytically distinguishable from the underlying activities.⁸² The fourth basic good is aesthetic experience.⁸³ It is similar to play, however, unlike play it does not need to involve an action of one’s own; rather” what is sought after and valued for its own sake may simply be the beautiful form “outside” one, and the “inner” experience of appreciation of its beauty.” Sociability is the next basic good.⁸⁴ It is easily understood as some collaboration between one person and another.⁸⁵ There are ranging ebbs of this good, “in its weakest form (it) is realized by a minimum of peace and harmony amongst persons, and its strongest form in the flowering of full friendship.”⁸⁶ The sixth good is that of practical reasonableness. Finnis describes this as being able to “to bring one’s own intelligence to bear effectively... on the problems of choosing one’s actions and lifestyle and shaping one’s own character.”⁸⁷ This basic good involves intellectual freedom, and the freedom of choice in one’s actions.⁸⁸ Finnis’s last basic good is that

⁷⁶ Id. at 85.

⁷⁷ Id.

⁷⁸ Id. at 86.

⁷⁹ Id.

⁸⁰ Id. at 87.

⁸¹ Id.

⁸² Id.

⁸³ Id.

⁸⁴ Id at 88.

⁸⁵ Id.

⁸⁶ Id.

⁸⁷ Id.

⁸⁸ Id 88-89.

of religion.⁸⁹ Finnis does not expound that an established form or religion is a basic good; rather, he describes this good as “the establishment and maintenance of proper relationships between oneself... and the divine.”⁹⁰ He also mentions that this religion, as a basic good, is a person’s sense of responsibility as it relates to the use of the other basic goods.⁹¹

Finnis explains that among the seven basic universal goods, there is no hierarchy but rather each good is of equal importance. The basic goods are fundamental to the existence of each human being. Finnis argues that these goods are “each worth having for their own sake, and not as a means of obtaining other goods.”⁹² Additionally, in the pursuit of all basic goods, Finnis claims that it’s inevitable for some goods to take precedence over others in an individual’s life.⁹³ We now examine which goods are at stake in the moral critique of FATCA. The basic goods at stake in the analysis include: (i) life, (ii) knowledge and (iv) practical reasonableness.

Life

One of the values at stake in the enactment of FATCA is life. According to Finnis, “the term life signifies every aspect of the vitality of life which puts a human being in good shape for self-determination. Hence, life here includes bodily (including cerebral) health, and freedom from the pain that betokens organic malfunctioning or injury.”⁹⁴ Life, therefore, includes every facade of human existence that leads one to determine their path.⁹⁵ Finnis argues that “life”, the first basic value, corresponds “to the drive for self-preservation.”⁹⁶

⁸⁹ Id. at 89.

⁹⁰ Id.

⁹¹ Id.

⁹² Id. at 105.

⁹³ Id. at 90.

⁹⁴ Id. at 86.

⁹⁵ Id. at 87-89.

⁹⁶ Id.

As human beings, we strive to survive and endure but sometimes at the expense of others. Tax evasion is the product of individuals doing exactly that— undermining the basic good of life. It is well known that the taxation system, although an economic scheme, has a major effect on the quality of life of human beings. Taxes are a major source of revenue, used for a plethora of public services and programs aimed to help communities, most notably those poverty stricken.⁹⁷ An estimated \$30 billion in income taxes goes uncollected annually due to income tax evasion.⁹⁸ This taxation revenue could be used to build more schools, create jobs or even provide food to poor families.

Much of the uncollected taxes are a result of tax evasion, due to non-reporting of offshore accounts and assets.⁹⁹ Many wealthy individuals and corporations enjoy having income untaxed in their tax havens. This massive withholding of revenue directly affects the quality of life of the rest of the populace, notably the poor and middle class. The billions in tax revenue uncollected each year could be used to help the physical, mental and emotional problems which plague persons in these economic classes.

As a solution, FATCA helps curb tax evasion and tap into additional revenue to further the quality of life of others, especially those less fortunate. FATCA recognizes that people's livelihoods are important. Under FATCA, U.S. tax payers must adhere to various reporting procedures and are subject to non-compliance penalties. The statute's intent is effectively to make sure all people have a fair shot at life and others don't enjoy life at the expense of others. Therefore, FATCA promotes the basic good of life.

⁹⁷ Allingham M. G. and A. Sandmo. (1972) "Income Tax Evasion: A Theoretical Analysis". *Journal of Public Economics*. 1 (3/4) pp. 323-340.

⁹⁸ Rossotti, Charles O. 2002. "Report to the IRS Oversight Board: Assessment of the IRS and the Tax System," Internal Revenue Service, September.

⁹⁹ Id.

Knowledge

Another value at stake is knowledge. According to Finnis, “knowledge” is a basic value that is worth pursuing for its own sake rather than instrumentally.¹⁰⁰ Consequently, knowledge is a good that human beings should possess because it “orients one’s practical reasoning.”¹⁰¹ Finnis explains,

The value of truth is obvious and self-evident. It need not be and cannot be demonstrated. It is not innate but becomes obvious only to one who has experienced the urge to question, who has grasped the connection between question and answer, who understands that knowledge is constituted by correct answers to particular questions, and who is aware of the possibility of further questions and other questioners who like himself could enjoy the advantage of attaining correct answers.¹⁰²

Tax evasion is a direct violation of the basic value of knowledge. Tax evasion is the practice of misrepresenting income to avoid paying taxes. Under this scheme, information or “knowledge” regarding income and assets in foreign accounts is directly withheld for pecuniary gain.

Transparency of such financial information is essential to the health of the economy.

The IRS’s ability to tax income is based on the accuracy of self-reporting by tax payers. If individuals or corporations fail to report, the IRS isn’t able to tax unless they find out about the income or assets by other means. Further, the federal spending budget heavily relies on the effectiveness of the IRS to receive accurate financial information and thus retrieve revenue from taxes. This is crucial since the United States utilizes tax revenue for a majority of federal

¹⁰⁰ Finnis, at 87.

¹⁰¹ Id. at 63.

¹⁰² Id. at 65.

spending. Individual income taxes and payroll taxes accounted for 82 percent of all federal revenues in fiscal year 2010.¹⁰³

The objective of FATCA is the reporting of assets held offshore by U.S. persons. FATCA is an information reporting regime and, therefore, a key requirement for compliance is the filing of information returns (*e.g.*, Form 1042-S and Form 8966) on an annual basis.¹⁰⁴ Regardless of whether FATCA withholding is imposed, year-end reporting may nevertheless be required. When completing year-end reporting, US financial institutions will complete Forms 1042 and 1042-S that contain both FATCA withholding and reporting information along with chapter 3 withholding and reporting information.¹⁰⁵ As with withholding, a FATCA determination regarding reporting must be done before the reporting of chapter 3 information applies. Form 8966 is used solely for FATCA reporting when information regarding specific U.S. owners of owner documented FFIs or substantial U.S. owners of passive NFFEs is passed up to U.S. financial institutions.¹⁰⁶ Thus, FATCA promotes the basic value of knowledge and deters individuals from withholding information.

¹⁰³ U.S. Congress Joint Committee on Taxation, "Present Law and Historical Overview of the Federal Tax System," JCX-1-11, January 18, 2011.

¹⁰⁴ Treas. Reg. §§ 1.474-1(d)(i) (Discussing that every withholding agent must file an information return on Form 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," to report to the IRS chapter 4 reportable amounts that were paid to a recipient during the preceding calendar year.) 1.472-1(e)(2) (A withholding agent that receives information about any substantial U.S. owners of an NFFE that is not an excepted NFFE must report information about the NFFE's substantial U.S. owners in accordance with §1.1474-1(i)(2). See §1.1471-4(d) for the reporting requirements of a participating FFI with respect to the substantial U.S. owners of account holders that are NFFEs.) 1.1474-1(i)(1) (Beginning in calendar year 2014, if a withholding agent (other than an FFI reporting accounts held by owner-documented FFIs under §1.1471-4(d)) makes during a calendar year a payment of a chapter 4 reportable amount to an entity account holder or payee of an obligation and the withholding agent treats the entity as an owner-documented FFI under §1.1471-3(d)(6), the withholding agent is required to report for such calendar year with respect to each specified U.S. person, the withholding agent is required to report for such calendar year with respect to each specified U.S. person identified under §1.1471-3(d)(6)(iv)(A)(1) or (2). that has a direct or indirect debt or equity interest in such entity. Such report must be made on Form 8966 (or such other form as the IRS may prescribe) and filed on or before March 31 of the calendar year following the year in which the withholdable payment was made).

¹⁰⁵ Treas. Reg. § 1.1474-1 (c)

¹⁰⁶ Treas. Reg. §§ 1-1474-1(i)(2) (Discusses that beginning on July 1, 2014, in addition to the reporting on Form 1042-S, a withholding agent (other than an FFI reporting accounts held by NFFEs under §1.1471-4(d)) that receives information about any substantial U.S. owners of a NFFE that is not an excepted NFFE shall file a report with the IRS for the period from July 1 through December 31, 2014, and in each subsequent calendar year with respect to any substantial U.S. owners of such NFFE. 1.1474-1(i)(1)(i) (Beginning on July 1, 2014, if a withholding agent (other than an FFI reporting accounts held by owner-documented FFIs makes a withholdable payment to an entity account

C. Finnis' Requirements of Practical Reasonableness in relation to FATCA: The Nine Principles of Practical Reasonableness

The next good Finnis outlines as a universal good is practical reasonableness. Finnis asserts that practical reasonableness is what allows one to make decisions.¹⁰⁷ The good of practical reasonableness structures our pursuit of other basic goods, by shaping our participating in the other basic goods, guiding our commitments, and by guiding us as we carry out actions in pursuit of these goods.¹⁰⁸ This basic good is separated into nine guiding principles that assist in understanding Finnis' framework for Natural Law.¹⁰⁹ These principles are: (i) having a "coherent plan of life," (ii) not having an arbitrary preference amongst the basic goods, (iii) not having an arbitrary preference among persons, (iv) having a sense of detachment from projects undertaken, (v) not abandoning general commitments lightly, (vi) acting to bring about good with efficient, (vii) respecting every basic value in every act by never choosing against a basic good, (viii) favoring and fostering the common good in one's communities; and (ix) following one's own conscience.¹¹⁰

A Coherent Plan of Life

This first requirement of practical reasonableness is a coherent plan of life. According to Finnis, a coherent plan of life "must have a harmonious set of purposes and orientations, not as

holder or payee of an obligation and the withholding agent treats the entity as an owner-documented, the withholding agent is required to report for July 1 through December 31, 2014, with respect to each specified U.S. person that has a direct or indirect debt or equity interest in such entity.)

¹⁰⁷ Id. at 23.

¹⁰⁸ Id at 100- 102.

¹⁰⁹ Id at 100-103.

¹¹⁰ Id. See also Wallin, Alex W, John Finnis's Natural Law Theory and a Critique of the Incommensurable Nature of Basic Goods, *Campelle Law Review* 35 (Fall 2012)

the ‘plans’ or ‘blueprints’ of a pipe-dream, but as effective commitments.¹¹¹ Finnis argues that “it is unreasonable to live merely from moment to moment, following immediate cravings, or just drifting.”¹¹² Further, Finnis claims that “it is also irrational to devote one’s attention exclusively to specific projects which can be carried out completely by simply deploying defined means to defined objectives.”¹¹³

FATCA was developed and enacted in a comprehensive manner demonstrating Congress’ plan to curb tax evasion and ensure accurate financial reporting by U.S tax payers holding foreign financial assets. The statute and supplemental guidance provided by the IRS and Treasury clearly lays out a blue print with respect to when and how to report such information. The provisions of the act provide guidance to individuals and corporations alike with respect to compliance. Conversely, the act also clearly outlines penalties for failure to follow the procedures and avoid reporting taxable income and assets. All of the provisions are in harmony with the goal of combating tax evasion. Hence, FATCA, with respect to all its provisions, provides a coherent plan.

No Arbitrary Preferences Amongst Values

The second requirement of practical reasonableness is “no arbitrary preferences amongst values.” As human beings, Finnis maintains, that “there must be no leaving out of account, or arbitrary discounting or exaggeration, of any of the basic human values.”¹¹⁴ As we pursue a coherent plan of life, “some degree of concentration on one or some of the basic forms of good,

¹¹¹ Id. at 103-104.

¹¹² Id.

¹¹³ Id. at 104.

¹¹⁴ Id. at 105.

at the expense, temporarily or permanently of other forms of good” will occur.¹¹⁵ However, the subordination of the basic values should not be unreasonable and for the sake of instrumental goods such as wealth or opportunity.¹¹⁶ All basic values are implicated, in one form or another, in FATCA. However, the act primarily focuses on the basic goods of life, knowledge and reason.

Life is a basic value that is implicated since FATCA creates a level playing for U.S. taxpayers and furthers the quality of life for all. This is achieved by curbing tax evasion which gives unfair economic advantage to the wealthy, which often hold financial assets in foreign accounts. Because taxation has a direct effect on people’s lives, FATCA recognizes that comprehensive regulation is needed. Knowledge is taken into account by the reporting provisions within FATCA. Whether you’re an individual tax payer or a corporation, it doesn’t matter. Any individual or entity who holds financial assets in foreign accounts must report them if they meet the threshold requirements. The emphasis on knowledge and its transparency is the backbone of FATCA.

FATCA does not arbitrarily prefer amongst the basic universal values. The basic values of life, knowledge and practical reasonableness are only highlighted due to the nature of the provisions, objectives and purpose of the act. Finnis argues that “commitment will be rational only if is on the basis of one’s assessment of one’s capacities, circumstances, and even one’s tastes.”¹¹⁷ Moreover, the act actually deters U.S tax payers, through the penalty system, to subordinate the achievement of basic values with lesser goods like pursuit of individual wealth and opportunity.

¹¹⁵ Id.

¹¹⁶ Id.

¹¹⁷ Id.

No Arbitrary Preferences Amongst Persons

The third requirement of practical reasonableness is “no arbitrary preferences amongst persons.” Finnis argues that self-preference cannot be made through “selfishness, special pleading, double standard, hypocrisy, indifference to the goods of others whom one could easily help, and all other manifold forms of egoistic and group biases.”¹¹⁸ FATCA does not effectively single out a specific group of individuals when assessing compliance. The statute is meant to regulate any individual or entity that has financial assets in foreign accounts. The act does not provide for any distinctions between the poor, middle class or upper class. Anyone who doesn’t comply with FATCA can face penalties. The provisions are uniform and set on the objective of deterring tax evasion. As such, FATCA does not have arbitrary preferences amongst persons.

Detachment and Commitment

The fourth and fifth requirement of practical reasonableness is detachment and commitment. Both detachment and commitment are intrinsic in the pursuit of coherent life plan. Finnis argues that “there are often straightforward and evil consequences of succumbing to the temptation to give one’s particular project the overriding and unconditional significance which only a basic value and a general commitment can claim.” Those who engage in tax evasion are often not able to detach themselves from maximizing their wealth regardless of the means. FATCA solves the issue of the lack of detachment from lesser goods at the expense of basic goods. FATCA provides a scheme where “life” and “knowledge” are put at the forefront at the expense of furthering wealth by avoiding paying taxes.

¹¹⁸ Id.

The principle of commitment “establishes the balance between fanaticism and dropping out, apathy, unreasonable failure, or refusal to ‘get involved’ with anything.”¹¹⁹ At the very core of commitment is that “having made one’s general commitments one must not abandon them lightly.”¹²⁰ As U.S. citizens working and creating income, we have made commitment to our country and others to pay taxes. A commitment to being a tax payer is a serious and worthwhile commitment. FATCA ensures that we are held accountable for that commitment.

The (limited) Relevance of Consequences: Efficiency, within Reason

The sixth requirement of practical reasonableness is that one should “bring about good in the world (in one’s own life and the lives of others) by actions that are efficient for their (reasonable) purpose(s).” Finnis argues that one should waste their efforts on employing inefficient methods. “One’s actions should be judged by their effectiveness, by their fitness for their purpose, by their utility, their consequences...” In a Democracy that is built on the notion of taxation, it is not an effective method to avoid paying them. Not paying your taxes, can lead to penalties and even imprisonment. Withholding information regarding accounts in offshore locations doesn’t bring about the good in the world. It actually hurts others by withholding revenue that could help build our nation. FATCA is an effective method and brings about good for everyone because it deters individuals from escaping taxation for pecuniary gain.

Respect for Every Basic Value in Every Act

The seventh requirement of practical reasonableness is the respect for every basic value in every act. According to Finnis, “one should not choose to do any act of itself does nothing but

¹¹⁹ Id. at 110.

¹²⁰ Id.

damage or impeded a realization or participation of any one or more of the basic forms of human good. Tax evasion is a direct violation of a multitude of basic values. Those who engage in it are choosing to succumb to desire and personal gain at the expense of fundamental basic values. FATCA encourages the attainment of basic values such as life and knowledge and ultimately the common good. The damage that comes from avoiding paying taxes is not only the potential penalties but also the distancing from the common good.

The eighth requirement of practical reasonableness is the common good. The common good is all encompassing for “human beings, inasmuch life, knowledge, play aesthetic experience, friendship, religion and freedom in practical reasonableness is good for any and every person.”¹²¹ The elements of the common good establish the existence justice. Finnis argues that “the objective of justice is not equally but the common good, the flourishing of all members of the community, and there is no reason to suppose that this flourishing of all is enhanced by treating everyone identically when distributing roles, opportunities, and resources.”¹²² Distributive justice deals with “how we ought to share in the common stock and incidents (for example, natural resources, profits, taxes and offices) of communal enterprise.”¹²³

FATCA, with respect to its provisions and purpose does promote the common good as defined by Finnis. Additionally, it also promotes distributive justice. FATCA provides a plan to how individuals and corporations should conduct themselves with respect to reporting financial asset information. FATCA creates a fair scheme for citizens to engage in economic activity in. As such, the statute promotes the common good.

¹²¹ Id. at 115.

¹²² Id. at 174.

¹²³ Finnis, John. “Natural Law and Legal Reasoning.” In *Natural Law Theory: Contemporary Essays*, ed. Robert P. George, 134-157. Oxford: Clarendon Press, 1992.

Following One's Conscience

The last requirement of practical reasonableness is following one's conscience. The requirement mentions that one must act "in accordance with one's conscience." Finnis perspective on this principle is similar to that of Thomas Aquinas who said,

If one is not so fortunate in one's inclinations or upbringing, then one's conscience will mislead one, unless one strives to be reasonable and is blessed with a pertinacious intelligence alert to the forms of human good yet undeflected by the sophistries which intelligence so readily generates to rationalize indulgence, timeserving, and self-love.¹²⁴

In the tax evasion content, there is fundamentally something wrong with being dishonest in order to maximize one's wealth. The practice of withholding financial information in order to avoid taxation is not only immoral but against the shared values of society. FATCA sets out regulations that represent the conscience of society and the essence of the common good. As such, taxation regulation, like FATCA, comports with the consciences of all.

Conclusion

The nine requirements of practical reasonableness are essential to living a moral life. Finnis maintains,

Not every one of the nine requirements has a direct role in every moral judgment, but some moral judgments do sum up the bearing of each and all of the nine of the questions in hand, and every moral judgment sums up the bearing of one or more of the requirements.¹²⁵

As discussed throughout the article, FATCA has been a major combatant against the epidemic which is known as "tax evasion." An analysis based on the application of Finnis' basic goods

¹²⁴ Finnis, *Natural Law and Natural Rights*, at 125-126.

¹²⁵ *Id.* at 126.

and the nine principles of reasonableness shows that FATCA, in its entirety, does promote the common good. As such, the act is a morally reasonable and practical approach to preventing tax evasion.