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# THE FOREIGN ACCOUNT TAX COMPLIANCE ACT: A CONSTITUTIONAL ANALYSIS

By: Samantha McKay

## I. Introduction

The United States passport represents global freedom and opportunity.<sup>1</sup> It is ranked as the number one most powerful passport, and along with it comes one of the most coveted citizenships in the world.<sup>2</sup> Why, then, have more Americans than ever before decided to give it all up? In 2015, a record breaking 4,279 Americans renounced their U.S. citizenship.<sup>3</sup> These numbers do not represent a gradual increase, but a sudden spike in expatriates. While past decades have averaged at about 500 expatriates yearly, recent years have experienced an increase in upwards of 100% of Americans renouncing their citizenship.<sup>4</sup> Although it is not entirely clear why the number of expatriates has increased so drastically in recent years, some experts attribute this activity to the Foreign Account Tax Compliance Act (“FATCA”).<sup>5</sup>

FATCA was enacted in 2010 with the objective of preventing tax evasion by U.S. taxpayers with offshore accounts, or more specifically, “the deliberate and illegal hiding of assets

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<sup>1</sup> The United States passport offers citizens the global freedom and opportunity to travel to 147 different countries. PASSPORT INDEX, <https://www.passportindex.org/byRank.php> (last updated 2015).

<sup>2</sup> *Id.* The United States passport is tied with the United Kingdom as the number 1 most powerful passport, each offering passport holders the ability to travel to 147 different countries.

<sup>3</sup> Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 26,618 (May 8, 2015); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 45,709 (July 31, 2015); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 80 Fed. Reg. 65,851 (Oct. 27, 2015); Quarterly Publication of Individuals, Who Have Chosen to Expatriate, as Required by Section 6039G, 81 Fed. Reg. 6,598 (Jan. 8, 2016).

<sup>4</sup> In 2009, the number of published expatriates was 742. This number increased by 106% in 2010 with 1,534 expatriates. In 2011 the number of expatriates again increased, this time by 16% to 1,781 expatriates. 2012 resulted in a 47% decrease with 932 expatriates. The number again increased to 2,999 expatriates in 2013. This was a 221% increase from 2012 and a 68% increase from previous high of 2011. The number of expatriates continued to grow in 2014 by 13% with 3,415 expatriates, and again by 25% in 2015 with 4,279 expatriates in 2015. From 2009 to 2015, there has been a 476% increase in expatriates with every year after 2010 setting a new record high with the exception of 2012. Ryan E. Dunn & Andrew Mitchel, *New Expatriate Record for 2015 – Nearly 4,300 Expatriations*, INT’L TAX BLOG (Feb. 5, 2016), [http://intltx.typepad.com/intltx\\_blog/2016/02/new-expatriate-record-2015-nearly-4300-expatriations.html](http://intltx.typepad.com/intltx_blog/2016/02/new-expatriate-record-2015-nearly-4300-expatriations.html).

<sup>5</sup> *Record number of Americans living abroad renounce citizenship*, RT QUESTION MORE, <https://www.rt.com/usa/256921-Americans-renounce-us-citizenship/> (May 8, 2015); 26 U.S.C. §§ 1471-1474.

and income from the IRS by U.S. citizens and residents.”<sup>6</sup> It achieves this goal by imposing reporting requirements on individuals with assets in foreign accounts, and on foreign financial institutions with American account holders.<sup>7</sup>

FATCA was crafted as a solution to the global problem of tax evasion. It is estimated that an excess of \$100 billion of tax revenue are lost annually due to tax evasion.<sup>8</sup> The United States collects income taxes through a “voluntary compliance” program, in which taxpayers self-assess the amount of taxes owed, self-report the amounts by filing the appropriate forms, and make payments to cover said liability.<sup>9</sup> It is enforced primarily through withholding procedures that typically require employers to retain a portion of the taxpayer’s wages and submit it directly to the IRS, which then applies these withheld amounts against the taxpayer’s tax obligation.<sup>10</sup> Unfortunately, this system of self-assessment has led to compliance problems such as non-filing, underpayment, and underreporting, resulting in a “tax gap” made of the difference between taxes owed and taxes actually collected by the IRS each year.<sup>11</sup> Several high profile prosecutions have brought an increased public awareness to the glitches with voluntary compliance, such as the controversy of the Union Bank of Switzerland (“UBS”), which revealed “nearly \$20 billion in

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<sup>6</sup> *Foreign Bank Account Reporting and Tax Compliance: Hearing Before the Subcomm. On Select Rev. Measures of the H. Comm. on Ways & Means* [hereinafter *Hearing*], 111th Cong. 13 (2009).

<sup>7</sup> *Foreign Account Tax Compliance Act*, INTERNAL REVENUE SERVICE <https://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA> (last updated July 15, 2015). The details of the exact reporting requirements of FATCA on both foreign financial institutions and on individuals will be discussed *infra* section III. A.

<sup>8</sup> Jane G. Gravelle, *Tax Havens: International Tax Avoidance and Evasion*, CONGRESSIONAL RESEARCH SERVICE, 1 (Jan. 15, 2015), <http://www.fas.org/sgp/crs/misc/R40623.pdf>.

<sup>9</sup> Mark R. Van Heukelom, *The Foreign Account Tax Compliance Act and Foreign Insurance Companies: Better to Comply Than to Opt Out*, 39 J. CORP. L. 155, 158 (2013).

<sup>10</sup> *Id.* (“Withholding has proven to be the single most effective enforcement mechanism for collecting taxes on income from labor.” (quoting Lily Kahng, *Investment Income Withholding in the United States and Germany*, 10 FLA. TAX REV. 315, 323 (2011))).

<sup>11</sup> *Id.*

hidden assets, 52,000 secret bank accounts, confidential informants, court proceedings, and a \$780 million fine.”<sup>12</sup>

Despite the colossal necessity to thwart offshore tax evasion, not all have welcomed FATCA with open arms. Its enactment has resulted in public outcry, with many claiming that FATCA is unnecessarily burdensome and detrimental to taxpayer rights.<sup>13</sup> It is allegedly responsible for the vast increase of expatriates in the years following its enactment.<sup>14</sup> It is also claimed to have resulted in many foreign financial institutions closing the accounts of U.S. citizens to escape the burdens of complying with FATCA reporting requirements.<sup>15</sup> In addition to the general public outcry in response to its enactment, FATCA has also been challenged as unconstitutional.<sup>16</sup>

This note will examine the Foreign Account Tax Compliance Act and analyze its constitutionality under the Fourth Amendment. Part II will discuss the events that led to the need for the Foreign Account Tax Compliance Act, centered on international tax evasion and the inadequacies of previous attempts to curb said evasion. Part III will illustrate the details of Congress’s response to tax evasion through its enactment of FATCA, and discuss the public response to its implementation. Part IV will analyze the constitutionality of FATCA under the Fourth Amendment and argue that FATCA is an unreasonable search. Finally, Part V will offer a solution to the constitutional conundrum created by FATCA’s reporting requirements.

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<sup>12</sup> Niels Jense, *How to Kill the Scapegoat: Addressing Offshore Tax Evasion with a Special View to Switzerland*, 63 VAND. L. REV. 1823, 1824 (2010).

<sup>13</sup> See NAT’L TAXPAYER ADVOCATE, 2016 Annual Objectives Report to Congress, 48 *The IRS’s Implementation of FATCA Has in Some Cases Imposed Unnecessary Burdens and Failed to Protect the Rights of Affected Taxpayers*. [http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2016-JRC/Volume\\_1.pdf](http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2016-JRC/Volume_1.pdf).

<sup>14</sup> Taylor Denson, *Goodbye, Uncle Sam? How the Foreign Account Tax Compliance Act is Causing a Drastic Increase in the Number of Americans Renouncing Their Citizenship*, 52 HOUS. L. REV. 967, 979 (2015).

<sup>15</sup> *Id.* at 969-970.

<sup>16</sup> *Crawford v. United States Dep’t of the Treasury*, No. 3:15-CV-250, 2015 WL 5697552 (S.D. Ohio Sept. 29, 2015).

## II. The Need for FATCA

FATCA was drafted as a response to the need for global tax transparency.<sup>17</sup> In recent years, several events have increased public awareness regarding just how severe offshore tax evasion has become. This section will illustrate these events that gave rise to the need and implementation of FATCA. It will discuss the global problem of tax evasion, including the scandals that gave rise to the public awareness and political response to curb tax evasion. This section will also describe previous tax reporting requirements and their inadequacies to stop offshore tax evasion.

### A. Tax Evasion

The United States asserts a broad taxing jurisdiction.<sup>18</sup> It is the only economically developed country that practices citizenship-based taxation.<sup>19</sup> Many U.S. taxpayers avoid these taxes through the use of offshore accounts in other jurisdictions.<sup>20</sup> Offshore tax evasion has led to an estimated loss of anywhere from \$40 billion to upwards of \$100 billion of revenue each year.<sup>21</sup>

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<sup>17</sup> *Hearing*, *supra* note 6, at 7.

<sup>18</sup> Ann C. Kossachev, *Worldwide Taxation and FATCA: A Constitutional Conundrum or The Final Piece of The Tax Evasion Puzzle*, 25 GEO. MASON U. CIV. RTS. L.J. 217, 229 (2015). “Congress is given broad discretion to enact laws or engage in activities that assist in the execution of the powers in the Constitution through the Necessary and Proper Clause. Clause 1 of Article 1, Section 8 grants Congress the taxing power; and ‘the phrase to provide for the common defense and general welfare by any means.’”

<sup>19</sup> Ruth Mason, *Citizenship Taxation*, 89 S. CAL. L. REV. 101, 111-112 (2015). “[I]n addition to those physically present, and contrary to the practice of other countries, the United States also taxes its citizens and lawful permanent residents (green-card holders) on their worldwide income, no matter where in the world they reside and no matter how long they reside there. Thus, when nationals of other countries move abroad, sooner or later their state of nationality stops taxing them. But the United States never stops taxing its citizens and green-card holders, no matter how long they lived abroad.”

<sup>20</sup> Gravelle, *supra* note 8, at 1.

<sup>21</sup> It is difficult to estimate an exact loss of revenue from individual tax evasion “because the initial basis of the estimate is the amount of assets held abroad whose income is not yet reported to the tax authorities. In addition to this estimate, the expected rate of return and tax rate are needed to estimate the revenue cost.” Different estimates have been made by experts using different rates of return and tax rates. An estimate by Joseph Guttentag and Avi-Yonah determined a \$50 billion loss, while the Tax Justice Network determined an estimate close to a \$100 billion loss. Gravelle, *supra* note 8, at 27.

The primary incentive for using other jurisdictions to evade taxes stems from the fact that other countries either do not impose an income tax or levy it at a low rate, encouraging foreigners to keep income in their banks.<sup>22</sup> In addition, the banking secrecy and privacy laws of foreign countries differ.<sup>23</sup> Some of these privacy laws protect the identity of its account holders, “creating a secure and tax-evasion friendly sanctuary for those subject to U.S. and other nations’ tax laws.”<sup>24</sup>

Avoiding reporting income is easily done through the use of offshore accounts in a secretive jurisdiction with low tax.<sup>25</sup> A common technique is to simply open an account in a foreign bank or purchase foreign investments outside of the U.S. and not report the income.<sup>26</sup> Additionally, trusts or shell corporations could be created to “take advantage of U.S. tax laws that exempt interest income and capital gains of non-residents from U.S. tax.”<sup>27</sup> The utilization of these tax havens create loopholes that aid U.S. taxpayers in evading taxes, despite the efforts of the IRS to compel compliance, as described below.

## **B. Inadequacies of Prior Compliance Efforts**

Offshore tax evasion is not a new practice.<sup>28</sup> However, the IRS has had little success in its prior efforts to realize offshore account tax compliance. This is because the U.S. relies on the

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<sup>22</sup> Melissa A. Dizdarevic, *The FATCA Provisions of the Hire Act: Boldly Going Where No Withholding Has Gone Before*, 79 Fordham L. Rev. 2967, 2972 (2011).

<sup>23</sup> *Id.*

<sup>24</sup> Bruce W. Bean & Abbey L. Wright, *The U.S. Foreign Account Tax Compliance Act: American Legal Imperialism?*, 21 ILSA J. INT’L & COMP. L. 333, 338 (2015).

<sup>25</sup> Dizdarevic, *supra* note 22, at 2973. Jurisdictions with low or no taxes and secretive privacy or banking laws that U.S. citizens use as loopholes to evade U.S. taxes are referred to as “tax havens.” Gravelle, *supra* note 8, at 3.

<sup>26</sup> Gravelle, *supra* note 8, at 24.

<sup>27</sup> *Id.*

<sup>28</sup> The use of offshore tax evasion can be traced back as early as 1937 from a Letter to President Roosevelt in which the U.S. Secretary of Treasury describes the “principal devices now being employed by taxpayers with large incomes for the purpose of defeating the income taxes which would normally be payable by them.” *See*, Letter from Henry Morgenthau, Jr., U.S. Sec’y of Treasury, to Franklin D. Roosevelt, President of U.S. (May 29, 1937), available at <http://www.presidency.ucsb.edu/ws/index.php?pid=15413axzz1qRIOpHZ8>.

voluntary compliance of its citizens to determine tax liabilities on foreign-held money.<sup>29</sup> Many U.S. taxpayers with international income do not comply with reporting requirements, either intentionally or due to a lack of understanding of their reporting obligations.<sup>30</sup> Efforts of the IRS to determine the accuracy of tax filings are further hindered by the local laws of other nations that protect banking secrecy and information privacy.<sup>31</sup> This section will describe the enforcement tools in place prior to FATCA and their inadequacies in effectively compelling compliance.

The Report of Foreign Bank and Financial Accounts (“FBAR”) is a form that a U.S. taxpayer must complete annually if he has one or more foreign accounts with an aggregate value exceeding \$10,000 during a year.<sup>32</sup> The form is filed directly with the Department of Treasury, and is done separately from the form 9938 that must be filed with the taxpayer’s income tax return.<sup>33</sup> The FBAR requires subjected taxpayers to list and provide information about all of their foreign accounts, and failure to file an FBAR results in fines and penalties.<sup>34</sup> However,

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<sup>29</sup> Heukelom, *supra* note 9, at 157.

<sup>30</sup> U.S. taxpayers are required to report income earned through financial activity in offshore jurisdictions. They are also obligated to report any assets held outside of the U.S. with an aggregate value greater than \$10,000. Many Americans are unaware of this requirement. Denson, *supra* note 14, at 975.

<sup>31</sup> Yvonne Woldeab, “Americans: We Love You, But We Cant Afford You”: *How the Costly U.S.-Canada FATCA Agreement Permits Discrimination of Americans in Violation of International Law*, 30 AM. U. INT’L L. REV. 611, 618 (2015).

<sup>32</sup> 31 C.F.R. §§103.24-27 (2010); FBAR is mandated by the Bank Secrecy Act, which requires individuals to report identities and relationships of parties involved in transactions with foreign financial entities. 31 U.S.C. § 5314 (2006). Exceptions to the Reporting Requirement include: Certain foreign financial accounts jointly owned by spouses; United States persons included in a consolidated FBAR; Correspondent/Nostro accounts; Foreign financial accounts owned by a government entity; Foreign financial accounts owned by an international financial institution; Owners and beneficiaries of U.S. IRAs; Participants in and beneficiaries of tax-qualified retirement plans; Certain individuals with signature authority over, but no financial interest in, a foreign financial account; Trust beneficiaries if a U.S. person reports the account on an FBAR filed on behalf of the trust; and foreign financial accounts maintained on a United States military banking facility. *Report of Foreign Bank and Financial Accounts (FBAR)*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Report-of-Foreign-Bank-and-Financial-Accounts-FBAR> (last updated Dec. 11, 2015).

<sup>33</sup> *Report of Foreign Bank and Financial Accounts*, *supra* note 32.

<sup>34</sup> Failure to file a complete and/or accurate FBAR are subject to a penalty not to exceed \$10,000 per violation that is nonwillful and not due to reasonable cause. For each willful violations, the penalty increases to the greater of \$100,000 or 50 percent of the balance in the account at the time of the violation. *Id.*

since the FBAR relies on self-reporting, it has been ineffective in its efforts with taxpayer compliance.<sup>35</sup>

The Qualified Intermediary Program attempted to enlist the participation of foreign banks to help the IRS achieve its compliance goals.<sup>36</sup> The program involves voluntary agreements between foreign banks and the IRS, in which the participating banks withhold and report the appropriate amount of tax of its U.S. account holders.<sup>37</sup> While it appeared to be on the right track by incentivizing banks to withhold and report, instead of relying on the self-reporting method, the Qualified Intermediary Program has not effectively accomplished its goals. Many loopholes were found that allowed the foreign banks to aid their U.S. clients in avoiding reporting requirements, as illustrated in the section below.<sup>38</sup>

### **C. Tax Evasion Scandals**

The inadequacy of these previous tools used to realize tax compliance is displayed by the highly publicized scandals that took place in 2008. These scandals brought tax evasion into the public eye and confirmed the need for a new solution to effectively increase compliance. For example, in February 2008, German tax authorities shared customer account information purchased from an employee at Liechtenstein Global Trust (“LGT”).<sup>39</sup> This resulted in the prosecution of over 100 U.S. taxpayers with offshore accounts at LGT.<sup>40</sup>

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<sup>35</sup> Woldeab, *supra* note 31, at 619.

<sup>36</sup> Diszdarevic, *supra* note 22, at 2978.

<sup>37</sup> See generally, Treas. Reg. § 1.1441-1 (1997).

<sup>38</sup> Bean & Wright, *supra* note 24, at 340.

<sup>39</sup> An employee at LGT, Heinrich Kieber, “sold a DVD containing the details of 2,000 client accounts worth more than €4 billion for a reported €4.2 million (\$6.47 million).” *Liechtenstein Tax Evasion Scandal: Informant in German Investigation ‘Fears’ for his Life*, SPEIGEL ONLINE INT’L (March 8, 2008, 2:20 PM), <http://www.spiegel.de/international/business/liechtenstein-tax-evasion-scandal-informant-in-german-investigation-fears-for-his-life-a-540283.html>.

<sup>40</sup> *IRS and Tax Treaty Partners Target Liechtenstein Accounts*, IRS NEWSWIRE (Feb. 26, 2008), <http://www.assetsearchblog.com/uploads/file/IRS%20and%20Tax%20Treaty%20Partners%20Target%20Liechtenstein%20Accounts.pdf>.



Closely following the LGT scandal was the UBS scandal. In May 2008, a former banker from the Union Bank of Switzerland was arrested and pleaded guilty to helping U.S. account holders evade U.S. taxes through their offshore accounts.<sup>41</sup> The guilty plea exposed a remarkable tax evasion scheme that UBS bankers used to protect their clients from U.S. detection, which included bankers smuggling diamonds in toothpaste tubes, encrypted computers, code words, and other “spy-like” techniques.<sup>42</sup> A highly publicized investigation revealed secret accounts held by 19,000 Americans.<sup>43</sup> Through the aid of UBS bankers, these secret U.S. accounts held a collective \$20 billion.<sup>44</sup> The DOJ settled with UBS for a \$780 million fine.<sup>45</sup> In addition, the bank also agreed to disclose information on 4,450 secret accounts.<sup>46</sup> Together, these scandals revealed the massive problem with offshore tax evasion and led to the legislative response of the Foreign Account Tax Compliance Act.

### **III. Legislative Response to Tax Evasion: The Foreign Account Tax Compliance Act**

FATCA was created as a legislative response to tax evasion. It is the frontrunner in the battle against offshore tax avoidance, and was developed as a “result of a growing public

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<sup>41</sup> Bradley Birkenfeld pleaded guilty to conspiring to defraud the United States on June 19, 2008 and was sentenced to 40 months incarceration. *Former UBS Banker Sentenced to 40 Months for Aiding Billionaire American Evade Taxes*, THE UNITED STATES DEP’T OF JUSTICE, (Aug. 21, 2009), <https://www.justice.gov/opa/pr/former-ubs-banker-sentenced-40-months-aiding-billionaire-american-evade-taxes>. In 2007, Birkenfeld came forward under the IRS’s whistleblower program and had been providing the IRS with information for months. However, his failure to disclose information on one of his largest accounts, belonging to Igor Olenicoff, resulted in his prosecution and prison sentence. J. Richard (Dick) Harvey, Jr., *Offshore Accounts: Insider’s Summary of FATCA and its Potential Future*, 57 VILL. L. REV. 471, 476 (2012).

<sup>42</sup> See, generally, Lisa Jucca, *Special Report: How the U.S. cracked open secret vaults at UBS*, REUTERS, (Apr. 9, 2010, 6:12 AM), <http://www.reuters.com/article/us-banks-ubs-idUSTRE6380UA20100409>; *A Swiss banker on trial A day of reckoning?*, THE ECONOMIST (Oct. 14, 2014), <http://www.economist.com/news/business-and-finance/21625354-what-was-raouls-role>; Lynnley Browning, *Ex-UBS Banker Pleads Guilty in Tax Evasion*, NY TIMES, (June 20, 2008), <http://www.nytimes.com/2008/06/20/business/20tax.html>.

<sup>43</sup> Lynnley Browning, *Pressured by I.R.S., UBS Is Closing Secret Accounts*, NY Times, (Jan. 8, 2009), <http://www.nytimes.com/2009/01/09/business/09ubs.html>.

<sup>44</sup> David S. Hilzenrath & Zachary A. Goldfarb, *UBS to Pay \$780 Million Over U.S. Tax Charges*, THE WASHINGTON POST, (Feb. 19, 2009), <http://www.washingtonpost.com/wp-dyn/content/article/2009/02/18/AR2009021802541.html>.

<sup>45</sup> *UBS Enters into Deferred Prosecution Agreement*, THE UNITED STATES DEP’T OF JUSTICE, (Feb. 18, 2009), <https://www.justice.gov/opa/pr/ubs-enters-deferred-prosecution-agreement>.

<sup>46</sup> Jason Ryan, *Secret No More: UBS to Divulge 4450 U.S. Client Names to Fraud Probers*, ABC NEWS, (Aug. 19, 2009), <http://abcnews.go.com/Blotter/story?id=8363725>.

awareness of the failures of prior international tax collection efforts.”<sup>47</sup> Its primary objective is to deter illegal hiding of assets and income and, as a result, raise revenue otherwise lost to offshore tax avoidance.<sup>48</sup> This section will describe the Foreign Account Tax Compliance Act. First, it will explain, in detail, the provisions that make up FATCA. Next, it will illustrate various responses that have transpired since its enactment.

## **A. Details of FATCA**

FATCA was designed to establish a “seamless global enforcement network that will be difficult to circumvent.”<sup>49</sup> Its enactment introduced §§ 1471-1474 and § 6038D to the Internal Revenue Code.<sup>50</sup> It aims to accomplish its goals of tax compliance by commanding the disclosure of U.S. taxpayers’ foreign accounts directly to the IRS by the foreign financial institutions where the U.S. accounts are held.<sup>51</sup> Disclosure is required on the individual level, as well as by foreign financial institutions.<sup>52</sup> Failure to disclose will result in penalties to both the taxpayers and the financial institutions.<sup>53</sup>

### **1. Individual Reporting**

Disclosure on the individual level relies on voluntary compliance from U.S. taxpayers holding certain foreign accounts.<sup>54</sup> Specifically, §6038D of the Internal Revenue Code requires the disclosure of those U.S. taxpayers holding an interest in a “specified foreign financial asset”

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<sup>47</sup> Sean Deneault, *Foreign Account Tax Compliance Act: A Step in the Wrong Direction*, 24 Ind. Int’l & Comp. L. Rev. 729, 733 (2014).

<sup>48</sup> Dizdarevic, *supra* note 22, at 2984-2985.

<sup>49</sup> Peter Nelson, *Conflicts of Interest: Resolving Legal Barriers to the Implementation of the Foreign Account Tax Compliance Act*, 32 VA. TAX REV. 387, 394 (2012).

<sup>50</sup> Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, § 501-35, 124 Stat. 71, 97-115 (2010).

<sup>51</sup> *Hearing, supra* note 6, at 3.

<sup>52</sup> *See*, 26 U.S.C. §6038D(a) (2010) for individual reporting requirements; *See, also* 26 U.S.C. § 1471(b) (2010) for FFI reporting requirements.

<sup>53</sup> *See*, 26 U.S.C. § 6038D(d) (2010) for the penalty for an individual’s failure to disclose; *see, also* 26 U.S.C. §1471(a) for the withholding tax on FFIs.

<sup>54</sup> “Any individual who, during any taxable year, holds any interest in a specified foreign financial asset shall attach to such person’s return of tax imposed by subtitle A for such taxable year the information described in subsection (c) with respect to each such asset if the aggregate value of all such assets exceeds \$50,000 (or such higher dollar amount as the Secretary may prescribe)” 26 U.S.C. § 6038D(a)(2010).

with an aggregate value that exceeds \$50,000 during the taxable year.<sup>55</sup> A specified foreign financial asset is further defined as “any financial account maintained by a foreign financial institution” as well as some assets not held or maintained by a financial institution, including “any stock or security issued by a person other than a United States person, any financial instrument or contract held for investment that has an issuer or counterparty which is other than a United States person, and any interest in a foreign entity.”<sup>56</sup>

In addition to the maximum value of the foreign asset during the taxable year, the information that must be disclosed for any foreign account includes the name and address of the financial institution that houses the account, as well as the account number.<sup>57</sup> In regards to stocks or securities, taxpayers must reveal the name and address of the issuer and any information necessary to determine the class or issue of which the stock or security is a part.<sup>58</sup> Additionally, in the case of other instruments, contracts, or interests, the taxpayer must disclose any information necessary to identify the instrument, contract, or interest, as well as the names and addresses of all issuers and counterparties.<sup>59</sup>

The disclosure must be reported on an IRS form that is attached to the taxpayer’s annual income tax return.<sup>60</sup> This reporting requirement is done in addition to reporting required under FBAR, which can result in some duplicative reporting.<sup>61</sup> However, the FATCA requirements are much broader in scope in regards to the types of assets that must be reported.<sup>62</sup>

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<sup>55</sup> *Id.*

<sup>56</sup> 26 U.S.C. § 6038D(b) (2010).

<sup>57</sup> 26 U.S.C. §6038D(c) (2010).

<sup>58</sup> *Id.*

<sup>59</sup> *Id.*

<sup>60</sup> IRS Form 8939, IRS, available at <https://www.irs.gov/pub/irs-pdf/f8938.pdf>; 2015 Instructions for Form 8938 Statement of Specified Foreign Financial Assets, DEP’T OF THE TREASURY, INTERNAL REVENUE SERVICE, (Oct. 22, 2015), <https://www.irs.gov/pub/irs-pdf/i8938.pdf>.

<sup>61</sup> See, generally, *Recommendations for Published Guidance under IRC §§ 6038D and 1471: Eliminate Duplicative Reporting of Assets on the FATCA form 8938 if the Asset is Reported or Reflected on the FBAR (FinCEN Report 114) and Exclude Financial Accounts Maintained by a Financial Institution in the Country of Which the U.S. Person*

An individual's failure to report the necessary disclosures will result in a penalty of \$10,000.<sup>63</sup> Furthermore, if the failure to disclose continues for more than 90 days after the individual receives notice of such failure, the individual will receive an additional penalty of \$10,000 for every 30-day period of continued failure, not to exceed \$50,000.<sup>64</sup> However, the penalty may be waived if the failure to disclose is shown "to be due to reasonable cause and not due to willful neglect."<sup>65</sup>

## 2. FFI Reporting

The voluntary compliance by U.S. individual taxpayers is reinforced through the mandated participation of Foreign Financial Institutions ("FFIs").<sup>66</sup> By using the information that comes from FFIs holding the U.S. taxpayer's account, the IRS is able to verify the information supplied by the taxpayers.<sup>67</sup>

A foreign financial institution is defined as "any financial institution which is a foreign entity."<sup>68</sup> Further, a financial institution is defined as any entity that accepts deposits in the ordinary course of a banking or similar business; as a substantial portion of its business, holds financial assets for the accounts of others; or is engaged primarily in the business of investing, reinvesting, or trading securities, partnership interests, commodities, or any interest [thereof].<sup>69</sup> Essentially, the FFI has been broadly defined in order to include all foreign-owned entities involved in financial business. This was done so with the intention to make it "difficult to

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*is a Bona Fide Resident from FATCA Reporting*, Nat'l Taxpayer Advocate, (Apr. 13, 2015) available at <https://www.americansabroad.org/media/files/files/0400d365/tax-advocate-recommendations-13-april-2015.pdf>.

<sup>62</sup> See, generally, *Comparison of Form 8938 and FBAR Requirements*, INTERNAL REVENUE SERVICE, <http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements> (last updated March 25, 2016).

<sup>63</sup> 26 U.S.C. § 6038D(d) (2010).

<sup>64</sup> *Id.*

<sup>65</sup> 26 U.S.C. § 6038D(g) (2010).

<sup>66</sup> Dizdarevic, *supra* note 22, at 2977.

<sup>67</sup> *Id.*

<sup>68</sup> 26 U.S.C. § 1471(d)(4) (2010).

<sup>69</sup> 26 U.S.C. § 1471(d)(5) (2010).

imagine a financial institution that could offer tax avoidance strategies similar to those peddled by UBS without falling into coverage of the statute.”<sup>70</sup> In addition to the required FFI reporting, FATCA also reaches some Non-Financial Foreign Entities (“NFFEs”).<sup>71</sup> A NFFE is defined as “any foreign entity which is not a financial institution,” broadening the reach of FATCA even further.<sup>72</sup>

Broadly speaking, in order to comply with FATCA, participating FFIs must enter into agreements with the IRS, and report information about its U.S. accounts directly to the IRS.<sup>73</sup> This first requires FFIs to categorize their accounts based on a determination of which qualify as “U.S. Reportable Accounts.”<sup>74</sup> To do so, each FFI must search its existing accounts, and perform extensive due diligence on new customers for indicia associating the account with a U.S. person.<sup>75</sup> The FFI must then report to the IRS the identifying information of the account holders, such as the account numbers, the account balances, as well as gross receipts and withdrawals or payments from the account.<sup>76</sup> In addition to the initial information report, FFIs must continuously track the U.S. accounts throughout the life of the account and report this information on an annual basis.<sup>77</sup>

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<sup>70</sup> Nelson, *supra* note 48, at 392-393.

<sup>71</sup> 26 U.S.C. § 1472 (2010).

<sup>72</sup> 26 U.S.C. § 1472(d) (2010).

<sup>73</sup> 78 Fed. Reg. at 5874.

<sup>74</sup> *Agreement between the Government of the United States of America and the Government of [FATCA Partner] to Improve International Tax Compliance and to Implement FATCA*, U.S. DEP’T OF TREASURY, available at <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Reciprocal-Model-1A-Agreement-Preexisting-TIEA-or-DTC-6-6-14.pdf>. “U.S. Reportable Account” means a financial Account maintained by a Reporting [FATCA Partner] Financial Institution and held by one or more Specified U.S. Persons or by a Non-U.S. Entity with one or more Controlling Persons that is a Specified U.S. Person.”

<sup>75</sup> *Annex I: Due Dilligence Obligations for Identifying and Reporting on U.S. Reportable Accounts and on Payments to Certain Nonparticipating Financial Institutions*, U.S. DEP’T OF TREASURY, available at <https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Annex-I-to-Model-1-Agreement-11-4-13.pdf>.

<sup>76</sup> 26 U.S.C. § 1471(c) (2010).

<sup>77</sup> 26 U.S.C. § 1471(b)(1)(C) (2010).

If an FFI refuses to enter into such an agreement with the IRS or fails to report certain information on U.S. accounts, they must face a penalty, in which thirty percent of all withholdable payments is deducted by a withholding agent.<sup>78</sup> A withholdable payment is essentially any U.S.-source monetary transfer that an FFI depends on for business.<sup>79</sup> Furthermore, a withholding agent is defined as “all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment.”<sup>80</sup>

The withholding penalty was defined broadly as a way to effectively compel compliance and make it nearly impossible for FFIs to aid U.S. persons in tax evasion.<sup>81</sup> FATCA “offers foreign banks a simple choice – if you wish to access our capital markets, you have to report on U.S. account holders.”<sup>82</sup> The penalty may be steep, but it is designed as a way to compel compliance by taxpayers rather than to collect from them. It has been noted that IRS officials would consider the withholding requirement a success even if they do not collect “a dollar of withholding tax,” as long as it “helps to establish taxpayer trust in fairness of the system.”<sup>83</sup>

In addition to the withholding penalty on nonparticipating FFIs, FATCA requires participating FFIs to deduct a similar thirty percent tax on withholdable payments passing through the FFI en route to noncompliant individuals and entities.<sup>84</sup> The “passthru” payment is defined broadly to “cover payments that are not U.S.-source in the strict legal sense of the term,

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<sup>78</sup> *Id.*

<sup>79</sup> 26 U.S.C. § 1473(1) (2010).

<sup>80</sup> 26 U.S.C. § 1473(4) (2010).

<sup>81</sup> *See*, Nelson, *supra* note 49, at 395.

<sup>82</sup> Press Release, U.S. CONG., *Baucus, Rangel, Kerry, Neal Improve Plan to Tackle Offshore Tax Abuse Through Increased Transparency, Enhanced Reporting and Stronger Penalties* (Oct. 27, 2009) available at <https://www.highbeam.com/doc/1G1-216074212.html>.

<sup>83</sup> Alison Bennett, *Tax Havens: Musher Says IRS Focused on Timelines, Burden in Implementing FATCA Provisions*, 79 Daily Tax Rep. (BNA) G-2 (Apr. 27, 2010), available at [http://news.bna.com/dtln/DTLNWB/split\\_display.adp?fedfid=17022177&vname=dtrnot&fcn=7&wsn=793670000&fn=17022177&split=0](http://news.bna.com/dtln/DTLNWB/split_display.adp?fedfid=17022177&vname=dtrnot&fcn=7&wsn=793670000&fn=17022177&split=0) (subscription required). IRS Associate Chief Counsel, Steven Musher explained that a main goal is to “reconfirm the trust that taxpayers have in the international regime.” Since its enactment, my research leads me to believe that statistics have not yet been released on whether any withholding taxes have been collected.

<sup>84</sup> 26 U.S.C. § 1471(b)(1)(D) (2010). “The term ‘passthru payment’ means any withholdable payment or other payment to the extent attributable to a withholdable payment.” 26 U.S.C. § 1471(d)(7) (2010).

but are at least partially attributable to income generated in the country.”<sup>85</sup> The provision is used to prevent participating FFIs to allow nonparticipating FFIs and recalcitrant account holders to invest in the U.S. markets without complying with FATCA.<sup>86</sup>

### 3. Intergovernmental Agreements

In order to prevent FFIs from violating local laws, the Treasury has made over 100 intergovernmental agreements (“IGAs”) with authorities of foreign nations.<sup>87</sup> “The intergovernmental approach intends to remove legal impediments to FATCA compliance and reduces the anticipated financial burdens of compliance for foreign banks in the countries that make agreements.”<sup>88</sup> Different variations of Model IGAs have been created to use in an effort of collaboration with foreign governments to “ensure that the objectives of FATCA are fully met, regardless of bank secrecy laws.”<sup>89</sup>

Under the Model I IGA, instead of reporting directly to the IRS, FFIs provide the information to their government, which in turn discloses the appropriate information to the IRS. This agreement can be made reciprocal, where the U.S. would also agree to report information on foreigners’ bank accounts held in the United States.<sup>90</sup> Alternatively, the Model II IGA requires direct reporting by FFIs to the IRS.<sup>91</sup>

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<sup>85</sup> Nelson, *supra* note 49, at 397.

<sup>86</sup> *Id.* “If an account holder fails to provide sufficient information for an FFI to fulfill its reporting obligations, the account holder will be deemed ‘recalcitrant’ and will be subject to the punitive withholding tax” *Id.* at 394.

<sup>87</sup> Foreign Account Tax Compliance Act Resource Center, U.S. Dep’t of the Treasury, <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> (last updated March 24, 2016 4:33 PM). [hereinafter Resource Center].

<sup>88</sup> Frederic Behrens, *Using a Sledgehammer to Crack a Nut: Why FATCA Will Not Stand*, 2013 WIS. L. REV. 205, 215 (2013).

<sup>89</sup> Bean & Wright, *supra* note 24, at 352.

<sup>90</sup> U.S. Treasury Dep’t, *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA 13* (2012), available at <https://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf>.

<sup>91</sup> U.S. Treasury Dep’t, *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA [Non-Reciprocal Version]* (2012), available at <https://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf>.

The IGAs are negotiated in order to allow FATCA's enforcement without violating other countries' domestic laws, such as bank secrecy or privacy laws.<sup>92</sup> The IGAs are a way to get the full effect of FATCA. In order to ensure worldwide compliance with FATCA, a potential 190 different IGAs would need to be negotiated between the U.S. and other nations.<sup>93</sup> Currently, 112 countries have signed IGAs.<sup>94</sup>

## **B. Responses to the Legislature**

While it is clear that something had to be done about offshore tax evasion FATCA has received a variety of criticisms since its enactment. This section will explore the public outcry that has occurred, as well as a recent constitutional challenge to FATCA.

### **1. Initial Public Outcry**

Since the enactment of FATCA, many concerns and criticisms have evolved. One of those criticisms is that FATCA will have a potentially harmful impact on the U.S. capital market. Many FFIs have found that the easiest way to comply with FATCA, and avoid the thirty percent withholding penalty, is to withdraw from the U.S. markets altogether.<sup>95</sup> Upon the enactment of FATCA, a survey conducted by KPMG in 2011 revealed that, of the financial institutions polled, 39 percent have stated that they would either definitely, or potentially disinvest from the U.S. market.<sup>96</sup> Since the American economy is dependent on foreign investments, FATCA may put the United States at a disadvantage in the global market.<sup>97</sup>

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<sup>92</sup> Behrens, *supra* note 88, at 215.

<sup>93</sup> *Id.* at 216.

<sup>94</sup> Resource Center, *supra* note 87.

<sup>95</sup> Behrens, *supra* note 88, at 219.

<sup>96</sup> In 2011, KPMG conducted a survey of leading fund promoters in 12 countries. The majority of respondents had assets under management in excess of €10 billion, and more than half of the respondents distributed their shares in more than 10 countries. When asked if “[f]urther to FATCA, could your fund intend to disinvest from the U.S. equity market?” 42% responded “No”; 26% responded “Depends on the detailed implementation rules”; 7% responded “It is thinkable”; 6% responded “Yes”; and 19% did not answer. *FATCA and the funds industry: Defining the path*, KPMG (June 2011) available at <https://www.kpmg.com/BB/en/IssuesAndInsights/ArticlesPublications/Documents/fatca-and-the-funds-industry-defining-the-path.pdf>. My research has led me to believe that since FATCA has gone into effect, there has not yet



The implementation of FATCA has also resulted in the potential disparate treatment of U.S. persons living abroad. While most Americans living abroad will not owe any U.S. taxes due to the special deductions and exclusions, they must still file a tax return in both the country they reside as well as the U.S., which can lead to the possibility of double taxation.<sup>98</sup> While FATCA was intended to target Americans evading taxes through the use of offshore accounts, more will fall under the statute's reach, including many Americans living abroad.<sup>99</sup> Due to the harsh penalties of FATCA, Americans living abroad who hold foreign accounts have a high risk in any mistakes with filings.<sup>100</sup> Therefore, Americans living abroad must endure high expenses to retain tax consultants in order to ensure a correctly filed U.S. tax return.<sup>101</sup>

“Accidental Americans” may also be subject to FATCA unknowingly.<sup>102</sup> All persons born in the United States are deemed U.S. citizens, as are children born outside of the U.S. to

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been any evidence of disinvestment from the U.S. markets, nor has there been done any studies or surveys similar to KMPG's original survey.

<sup>97</sup> Behrens, *supra* note 88, at 218.

<sup>98</sup> The Foreign Earned Income Exclusion and the Foreign Housing Exclusion/Deduction are available to overseas Americans to help minimize the possibility of double taxation. In order to qualify for these deductions, taxpayers must meet wither the bona fide residence test, which is an American citizen who establishes his residence in a foreign country for an uninterrupted period during the taxable year, or the physical presence test, which requires the U.S. citizen's physical presence in a foreign country for 330 days in twelve consecutive months. Americans experience double taxation when a taxpayer's gross income exceeds the amount of excludable foreign-earned income. Denson, *supra* note 14, at 973. “While almost 82 percent of all Americans living abroad who filed their returns with the IRS owed no taxes, there is still the possibility that they can face double taxation.” Deneault, *supra* note 47, at 758.

<sup>99</sup> American Citizens Abroad, et al., *Residence-Based Taxation: A Necessary and Urgent Tax Reform*, 4 OVERSEAS AMERICANS WEEK 2013, archived at <http://perma.cc/7RDC-3DJH>.

<sup>100</sup> *Id.* at 5.

<sup>101</sup> *Id.* “For Americans abroad, U.S. tax filing is highly complicated, as foreign currencies must be converted into U.S. dollars and foreign transactions and arrangements must be interpreted according to U.S. tax law. To ensure compliance with U.S. tax law, overseas tax filers generally engage a tax lawyer or accountant knowledgeable in both local and U.S. tax systems. Such specialists are expensive and in many countries are almost impossible to find. Though most overseas filers owe no U.S. taxes, they end up paying significant compliance fees because of the complexity of the filings and because they receive little help from the IRS”

<sup>102</sup> *See, generally*, Allison Christians, *Understanding the Accidental American: Tina's Story*, TAX ANALYSTS (Dec. 8, 2015),

<http://www.taxanalysts.com/www/features.nsf/Features/4B25BA71D312B2D285257F1500682E46?OpenDocument>. Americans living abroad have different reporting thresholds than those living in the U.S. Americans living abroad must make the required FATCA disclosures when they have an aggregate value of \$200,000 as opposed to the \$50,000 threshold of individuals living in the United States. *Summary of FATCA Reporting for U.S. Taxpayers*,

American parents.<sup>103</sup> This rule subjects incidental citizens to FATCA, regardless of when they left the U.S., some of which may not even know that they are considered a U.S. citizen.<sup>104</sup> This may also bring FFIs unknowingly under the statute by having unaware “accidental” American account holders at their institution.<sup>105</sup> In addition to Americans living abroad, FATCA reaches even further to non-U.S. citizens. For example, all customers of participating FFIs, regardless of their connection to the U.S., must prove that they are not a U.S. person.<sup>106</sup>

Americans living abroad may also face unfair treatment from the countries in which they reside. Since disinvesting from the U.S. markets is not financially feasible for most FFIs, a number of them have decided to limit or terminate the services they offer to U.S. citizens.<sup>107</sup> Some banks would rather drop all of their American clients than report according to the strict standards under FATCA.<sup>108</sup> This has an incredibly disparate effect on Americans living abroad, who are finding themselves unable to go on about their lives normally while living abroad, due to the lack of access to banks or mortgages. This has led many to renounce their U.S.

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INTERNAL REVENUE SERVICE, <https://www.irs.gov/Businesses/Corporations/Summary-of-FATCA-Reporting-for-U.S.-Taxpayers> (last updated Nov. 4, 2015).

<sup>103</sup> U.S. CONST. amend. XIV § 1; 8 U.S.C. § 1401(c)-(d) (2012).

<sup>104</sup> Bean & Wright, *supra* note 24, at 353. While there are exceptions to overseas Americans and “accidental Americans,” if one is not aware of his or her status as a U.S. citizen, they may be unaware of their responsibilities and consequently the application of these exceptions. Upon finding out that one is an American citizen, there are steps an individual must take. “To avoid breaking any laws [individuals] will have to renounce his US citizenship and file five years’ worth of tax returns as well as possibly thousands of dollars to the US government in taxes on income he earned [abroad]” Siri Srinivas, *‘I was terrified we’d lose all our money’: banks tell US customers they won’t work with Americans*, *The Guardian*, (Sept. 24, 2014) <http://www.theguardian.com/money/2014/sep/24/americans-chased-by-irs-give-up-citizenship-after-being-forced-out-of-bank-accounts>.

<sup>105</sup> Bean & Wright, *supra* note 24, at 354. If a customer is unaware of his or her status as an American citizen, it may be difficult for the FFI to make the determination for each of its customers.

<sup>106</sup> Christians, *supra* note 102. FFIs must perform due diligence to determine whether any customers are U.S. citizens. After doing so, they must require their potential American customers to sign a withholding certificate (Form W-8BEN) claiming that they are *not* a U.S. citizen, under perjury of law. They must also request from the customers a certified copy of his or her certificate of loss of nationality. They must then determine whether the customer is a reportable account, and report the required information to the IRS. IRS Form w-8BEN, IRS, *available at* <https://www.irs.gov/pub/irs-pdf/fw8ben.pdf>.

<sup>107</sup> Srinivas, *supra* note 104.

<sup>108</sup> *Id.* “Scared of running afoul of US banking laws, foreign banks are taking extreme steps to limit US citizens to a narrow range of services.”

citizenships in order to either avoid the strict reporting requirements imposed by FATCA, or to better live a normal lifestyle in their resident country.<sup>109</sup> Since the implementation of FATCA, each year has resulted in more expatriates than ever before.<sup>110</sup>

There has also been concern about the primarily unilateral approach of FATCA and its impact on international relations.<sup>111</sup> FATCA essentially forces foreign countries and their financial entities into aiding the U.S. in implementing its tax laws, giving them the options to either comply with the statute, or forego access to the U.S. markets.<sup>112</sup> While the U.S. generally enjoys a level of respect internationally, the implementation of FATCA can have a negative impact on the relations between the U.S. and foreign countries.<sup>113</sup>

Finally, many are unsure of whether the benefits of increasing revenue compliance outweigh the burdens of heavy implementation costs. While it is predicted that FATCA will aid the IRS in collecting an additional \$800 million annually, compliance costs may average approximately \$5 million to \$10 million per FFI.<sup>114</sup> This results in roughly \$1 trillion to \$2 trillion in global compliance costs.<sup>115</sup>

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<sup>109</sup> *Id.*

<sup>110</sup> *See, supra* note 3 for numbers of expatriations by year.

<sup>111</sup> Deneault, *supra* note 47, at 755.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.* “ Understandably, the international community does not appreciate an actor who unilaterally imposes its will onto other countries to effectuate domestic policies.”

<sup>114</sup> Staff of Joint Comm. on Taxation, 111th Congress, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment to the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 2847, The “Hiring Incentives to Restore Employment Act”*, JCX-6-10 (2010), available at <https://www.jct.gov/publications.html?func=startdown&id=3650>; Frank Suess, *How Does FATCA Impact You?*, THE DAILY BELL <http://www.thedailybell.com/editorials/frank-suess-how-does-fatca-impact-you/> (Oct. 4, 2012).

<sup>115</sup> Suess, *supra* note 114.

## 2. A Move Toward Global Transparency

While the implementation of FATCA resulted in substantial criticisms, many of those initial criticisms have either not occurred as expected or have not yet occurred.<sup>116</sup> Alternatively, instead of resulting in a global crisis, FATCA has actually inspired other jurisdictions to further the notion of global tax transparency.<sup>117</sup> The Organization for Economic Cooperation and Development (“OECD”) has modeled its development of the Common Reporting Standard (“CRS”) after the objectives of FATCA.<sup>118</sup> The CRS was designed to “prevent the development of numerous competing standards for information exchange, and in doing so minimise potential costs and administrative burden for the financial sector.”<sup>119</sup>

Similarly to FATCA, the CRS requires financial institutions of participating jurisdictions to report information on its account holders of other participating jurisdictions, which requires due diligence procedures in order to identify reportable accounts.<sup>120</sup> Additionally, the CRS requires institutions to enter into agreements similar to the FATCA IGA in its efforts of achieving global exchange of information.<sup>121</sup> However, this global move toward global transparency comes with different requirements than the requirements of FATCA, with a broader

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<sup>116</sup> My research leads me to believe that there has not yet been sufficient studies or data on the treatment of overseas Americans by FFIs, or what the actual costs of compliance have been for FFIs since the implementation of the FATCA requirements.

<sup>117</sup> *Standard for Automatic Exchange of Financial Account Information: Common Reporting Standard* [hereinafter *Standard*], OECD, 5 available at <https://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-financial-account-information-common-reporting-standard.pdf>.

<sup>118</sup> *Id.* at 44. “The new standard draws extensively on earlier work of the OECD in the area of automatic exchange of information. It incorporates progress made within the European Union, as well as global anti-money laundering standards, with the intergovernmental implementation of the US Foreign Account Tax Compliance Act (FATCA) having acted as a catalyst for the move towards automatic exchange of information in a multilateral context.”

<sup>119</sup> Charles Yorke & David Stainer, *UK ‘son of FATCA’ and recent information exchange proposals*, TAX PLANNING INTERNATIONAL EUROPEAN TAX SERVICE, 3 [http://clientlink.allenoverly.com/Increative\\_preview/UK\\_son\\_of\\_FATCA\\_and\\_recent\\_information\\_%20exchange\\_proposals.pdf](http://clientlink.allenoverly.com/Increative_preview/UK_son_of_FATCA_and_recent_information_%20exchange_proposals.pdf).

<sup>120</sup> *Standard*, *supra* note 117, at 10-11.

<sup>121</sup> *See, Id.* at 12 for a model agreement under the CRS.

scope and no threshold for reporting requirements.<sup>122</sup> This means that some companies may find themselves in compliance with FATCA, but not under the CRS.<sup>123</sup>

### **3. Crawford et al v. U.S. Department of Treasury**

In September 2015, Senator Rand Paul, Mark Crawford, and others brought suit against the U.S. Department of Treasury for injunctive relief, claiming that FATCA is unconstitutional.<sup>124</sup> Specifically, the plaintiffs claimed that FATCA's Intergovernmental Agreements are unconstitutional sole executive agreements; that the account reporting requirements are unconstitutional under the Fourth Amendment and under the Equal Protection Clause; and that its penalties are unconstitutional under the Excessive Fines Clause.<sup>125</sup>

In an order denying the plaintiff's motion for preliminary injunctive relief based on a lack of standing, the constitutional challenges were only briefly discussed.<sup>126</sup> After determining that only one of the seven plaintiffs had standing, the Court limited its discussion to of the claims that applied to the plaintiff with standing.<sup>127</sup>

The court held that the challenge to the heightened reporting requirements for foreign financial accounts as denying U.S. citizens living abroad the equal protection of the laws would fail because the challenged provisions do not actually single out Americans living abroad, because the statute applies to all Americans with offshore accounts, regardless of residence.<sup>128</sup> It

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<sup>122</sup> Laurence Kiddle, *The differences between FATCA and CRS*, ECONOMIA, (Sept. 9, 2015) <http://economia.icaew.com/finance/september-2015/the-differences-between-facta-and-crs>.

<sup>123</sup> *Id.*

<sup>124</sup> Crawford v. United States Dep't of the Treasury, No. 3:15-CV-250, 2015 WL 5697552 (S.D. Ohio Sept. 29, 2015).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* at \*16. "[Plaintiffs] lack standing, as the harms they allege are remote and speculative harms, most of which would be caused by third parties, illusory, or self-inflicted."

<sup>127</sup> *Id.* at \*11-14. The only Plaintiff with standing (Daniel Kuettel) was limited to the claim that the heightened reporting requirements for foreign financial accounts denied U.S. citizens living abroad the equal protection of the law, and the claim that the willfulness penalty is unconstitutional under the Excessive Fines clause.

<sup>128</sup> *Id.* at \*13.

was further held that the statute is rationally related to the legitimate state interest of addressing offshore tax evasion and closing the gap between taxes due and taxes paid.<sup>129</sup>

The court also addressed the challenge to the penalty as unconstitutional under the Excessive Fines Clause, which the plaintiff claimed was “designed to punish” and “grossly disproportionate to the gravity of the offense.”<sup>130</sup> It was held that the Eighth Amendment claims were not ripe for adjudication since no withholding penalty had been imposed, nor would it ever be since the plaintiffs are individuals, not FFIs.<sup>131</sup>

The following analysis will focus on a constitutional challenge under the Fourth Amendment, which was not discussed in the Crawford decision but for a statement that the counts “are based on information reporting that does not violate the Constitution.”<sup>132</sup>

#### **IV. Constitutional Analysis**

This section will analyze the Foreign Account Tax Compliance Act in a constitutional capacity, specifically under the Fourth Amendment. It will begin with the United States Supreme Court precedent relevant to the analysis. It will then argue that reporting requirements of FATCA are an unreasonable search under the Fourth Amendment.

##### **A. Supreme Court Precedent**

The Fourth Amendment provides that “[t]he right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated...”<sup>133</sup> A search or seizure by a Government agent will be violated under the Fourth Amendment when, in order to obtain information, a search or seizure physically intrudes on a protected area or item, or, when the search or seizure implicates an individual’s reasonable

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<sup>129</sup> *Id.* at \*14.

<sup>130</sup> Crawford, WL 5697552, at \*14.

<sup>131</sup> *Id.*

<sup>132</sup> *Id.* at \*16.

<sup>133</sup> U.S. CONST. amend. IV.

expectation of privacy.<sup>134</sup> The following case law is the Supreme Court precedent relative to a discussion on the constitutional analysis of FATCA under the Fourth Amendment.

The court in *Katz* set forth the test for an expectation of privacy, which moved the analysis away from the traditional trespass test that had been exclusively relied on until then.<sup>135</sup> After Government agents placed an electronic listening device on a public phone booth in order to listen to the conversation, the court held that the Fourth Amendment was violated.<sup>136</sup> Although the individual had taken his phone call to a public area, the court held that the Fourth Amendment protects people and not things, and noted that even though something is brought into the public area, it can remain private if the individual takes steps to ensure this.<sup>137</sup> The concurring opinion set forth the two prongs later adopted as the “expectation of privacy test,” which asks 1) whether the individual had an actual, subjective expectation of privacy, and 2) whether that expectation of privacy is reasonably accepted by society.<sup>138</sup>

In *California Bankers Association v. Shultz*, the court was required to determine the constitutionality of the Bank Secrecy Act of 1970, which, not dissimilar to FATCA, required financial institutions to “maintain records of their customers’ identities, to make microfilm copies of checks and similar instruments, and to keep records of certain other items.”<sup>139</sup> In determining that the recordkeeping did not violate the Fourth Amendment, the court held that the

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<sup>134</sup> *Katz v. United States*, 389 U.S. 347 (1967); *Olmstead v. United States*, 277 U.S. 438 (1928).

<sup>135</sup> *Katz*, 389 U.S. 347 at 352 “[o]nce it is recognized that the Fourth Amendment protects people – and not simply ‘areas’ – against unreasonable searches and seizures it becomes clear that the reach of that Amendment cannot turn upon the presence or absence of a physical intrusion into any given enclosure.”

<sup>136</sup> *Id.* at 359.

<sup>137</sup> *Id.* at 351. In this case, the petitioner brought his conversation to a public phone booth. While it was in the public eye, being a clear booth, it was held that the petitioner “sought to exclude when he entered the booth was not the intruding eye – it was the uninvited ear. He did not shed his right to do so simply because he made calls from a place where he might be seen.”

<sup>138</sup> *Katz*, 389 U.S. 347, 361 (1967) (Harlan, J., concurring).

<sup>139</sup> *California Bankers Ass’n v. Shultz*, 416 U.S. 21 (1974).

provisions did not require any information contained in the records to be disclosed to the government, because access to the records “is to be controlled by existing legal processes.”<sup>140</sup>

In regards to the reporting requirements of the Act, which required the report of anyone connected to a foreign transaction exceeding \$5,000, the court held that they “do not authorize indiscriminate rummaging among the records of the plaintiffs.”<sup>141</sup> The court further held that “[t]he reports of foreign financial transactions required by the regulation must contain information as to a relatively limited group of financial transactions in foreign commerce, and are reasonably related to the statutory purpose of assisting in the enforcement of the laws of the United States.”<sup>142</sup>

Dissenting, Justice Douglas noted, “a person is defined by the checks he writes.”<sup>143</sup> He went on to describe the personal information that could be derived from bank records, such as “the doctors, lawyers, creditors, political allies, social connection, religious affiliation, educational interests, and the papers and magazines he reads, and so on ad infinitum.”<sup>144</sup> Justice Douglas discusses the expectation of privacy in bank records and states that what a person “seeks to preserve as private, even in an area accessible to the public, may be constitutionally protected.”<sup>145</sup> He then asserts that bank accounts are within the expectations of privacy due to the information that they reveal in addition to a person’s finances.<sup>146</sup> He further notes that just because the bank records are useful in criminal, tax, or regulatory investigations or proceedings,

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<sup>140</sup> *Id.* at 52.

<sup>141</sup> *Id.* at 62.

<sup>142</sup> *Id.*

<sup>143</sup> *California Bankers*, 416 U.S. 21 at 85 (Douglas, J., dissenting).

<sup>144</sup> *Id.*

<sup>145</sup> *Id.* at 89.

<sup>146</sup> *Id.*



that the collection of all citizens must be collected in saying that it is “unadulterated nonsense unless we are to assume that every citizen is a crook, an assumption I cannot make.”<sup>147</sup>

Justice Marshall delivers another dissent, in which he states that even though a person discloses private papers to the bank, it does not waive the right to privacy of the papers, because it is offered to the bank for a limited purpose under a confidential customer-bank relationship. He further notes that a customer of a bank “has a reasonable expectation that his check will be examined for bank purposes only – to credit, debit, or balance his account – and not recorded and kept on file for several years by Government decree so that it can be available for Government scrutiny.”<sup>148</sup>

The court in *U.S. v. Miller* further examined the Bank Secrecy Act when it addressed records maintained under the act that were obtained by allegedly defective subpoenas.<sup>149</sup> In holding that the records obtained were business records of the banks, the court noted that the banks are not neutral, but are parties to the transactions.<sup>150</sup> Additionally, the court noted, a lack of expectation of privacy in bank records was assumed by Congress in its enactment of the Bank Secrecy Act.<sup>151</sup> Furthermore, the court held that the depositor assumes the risk of his personal information being conveyed to the Government when revealing the information to a third party, “even if the information is revealed on the assumption that it will be used only for a limited purpose and the confidence placed in the third party will not be betrayed.”<sup>152</sup>

Justice Brennan dissented, asserting that bank customers have reasonable expectations that their documents transmitted in the course of business will remain private, and that “[a] bank customer’s reasonable expectation is that, absent compulsion by legal process, the matters he

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<sup>147</sup> *Id.* at 85.

<sup>148</sup> *California Bankers*, 416 U.S. 21 at 96 (Marshall, J., dissenting).

<sup>149</sup> *United States v. Miller*, 425 U.S. 435 (1976).

<sup>150</sup> *Id.* at 440.

<sup>151</sup> *Id.* at 442.

<sup>152</sup> *Id.* at 443.

reveals to the bank will be utilized by the bank only for internal banking purposes.”<sup>153</sup> In addition, he notes that it is “impossible to participate in the economic life of contemporary society without maintaining a bank account,” for which the depositor must reveal many aspects of his personal life.<sup>154</sup> Justice Brennan goes on to describe the potential abuse of police power by allowing access to the records upon request, with no judicial process to review and balance the societal and individual interests.<sup>155</sup>

The court in *Smith v. Maryland* held that the installation and use of a pen register, which revealed to the government the telephone numbers dialed from a suspect’s home phone did not constitute a search under the Fourth Amendment.<sup>156</sup> Since the installation of the pen register occurred at the phone company, and not the home of the petitioner, it was clear that no property had been invaded.<sup>157</sup> Therefore, in making its determination, the court was required to determine whether the petitioner had an actual and reasonable expectation of privacy in the numbers dialed from his home phone.<sup>158</sup>

In applying the *Katz* test, the *Smith* court first noted that the pen register only revealed the numbers dialed from a specific phone, but did not reveal any content of the conversations spoken during the call, or whether a communication even occurred.<sup>159</sup> The court went on to note that telephone users knowingly convey phone numbers to the telephone company, which are then used in the billing process.<sup>160</sup> Therefore, customers generally do not have an expectation that the

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<sup>153</sup> U.S. v. Miller, 425 U.S. 435 at 449 (Brennan, J., dissenting).

<sup>154</sup> *Id.* at 451.

<sup>155</sup> *Id.*

<sup>156</sup> *Smith v. Maryland*, 442 U.S. 735 (1979).

<sup>157</sup> *Id.* at 741. “[P]etitioner obviously cannot claim that his ‘property’ was invaded or that police intruded into a ‘constitutionally protected area.’”

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* at 742.

numbers they dial will remain secret, as they have assumed the risk of government disclosure by releasing their information to a third party.<sup>161</sup>

In a dissent delivered by Justice Stewart, it was asserted that telephone subscribers would not be happy to “have broadcast to the world a list of the local or long distance numbers they have called.”<sup>162</sup> It is further noted that the numbers dialed can reveal personal or incriminating information by revealing the identities of the persons called “and thus reveal[ing] the most intimate details of a person’s life.”<sup>163</sup> Further, a dissent delivered by Justice Marshall rebutted the assumption of risk customers providing their information to a third party.<sup>164</sup> In doing so, Justice Marshall discusses the lack of choice in the situation, stating that a customer “cannot help but accept the risk of surveillance” where there is no practical alternative.<sup>165</sup>

The Fourth Amendment analysis in *U.S. v. Jones* revolved around the installation of a GPS device onto a suspect’s car in order to monitor his movements.<sup>166</sup> The majority held that the physical intrusion to the vehicle constituted the installation as a violation to the Fourth Amendment.<sup>167</sup> Concurring opinions also held that a violation occurred, but they did so through an expectation of privacy analysis. In her concurring opinion, Justice Sotomayor discussed the new age of technology and its impact on society’s expectations of privacy when disclosing information to third parties.<sup>168</sup> She notes, “people disclose a great deal of information about themselves to third parties in the course of carrying out mundane tasks,” such as phone numbers to phone providers or URL and email addresses to internet providers.<sup>169</sup> She asserts that

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<sup>161</sup> *Id.*

<sup>162</sup> *Smith v. Maryland*, 442 U.S. 735 at 748 (Stewart J., dissenting).

<sup>163</sup> *Id.*

<sup>164</sup> *Smith v. Maryland*, 442 U.S. 735 at 749 (Marshall, J., dissenting).

<sup>165</sup> *Id.*

<sup>166</sup> *United States v. Jones*, 132 S.Ct. 945 (2012).

<sup>167</sup> *Id.* at 946.

<sup>168</sup> *United States v. Jones*, 132 S.Ct. 945 at 957 (Sotomayor, J., dissenting).

<sup>169</sup> *Id.*

although some believe people accept the “tradeoff of privacy for convenience” as “worthwhile” or “inevitable,” it is doubtful that anyone would accept disclosure of a list of every website that they visit.<sup>170</sup> She further states that all information voluntarily disclosed for a limited purpose should not waive someone’s entitlement to Fourth Amendment protection.<sup>171</sup>

In a further concurrence, Justice Alito mentions the circularity involved in the expectation of privacy test, stating that “judges are apt to confuse their own expectations of privacy with those of the hypothetical reasonable person.”<sup>172</sup> He also believes that changes in technology and availability of cheaper access and newer devices can change society’s expectations of privacy.<sup>173</sup> Further, Justice Alito discusses the implications of the length of time of the surveillance.<sup>174</sup> He states that the expectations of privacy are affected because society would not expect law enforcement agencies to secretly monitor their every movement for a prolonged period, which was approximately four weeks in *Jones*.<sup>175</sup>

## **B. Fourth Amendment Analysis**

The Foreign Account Tax Compliance Act requires that foreign financial institutions report specific information on all of its accounts held by U.S. citizens with an aggregate balance of \$50,000 during the taxable year.<sup>176</sup> The information that must be reported includes the name and address of the account holder, as well as the account number and balance, withdrawals, or payments from the account.<sup>177</sup> The FFI must report this information on each of its American

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<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *United States v. Jones*, 132 S.Ct. 945 at 962 (Alito, J., dissenting).

<sup>173</sup> *Id.* at 963.

<sup>174</sup> *Id.* at 964.

<sup>175</sup> *Id.*

<sup>176</sup> 26 U.S.C. § 1471 (2010).

<sup>177</sup> 26 U.S.C. § 1471(c) (2010).

accounts on an annual basis, or it will be subject to a thirty percent withholding tax on all withholdable payments.<sup>178</sup>

## **1. The Reporting Requirements are Searches Under the Fourth Amendment**

In beginning a constitutional analysis of FATCA, it must first be determined whether the Fourth Amendment applies to the reporting requirements. Since there is no physical intrusion on a protected area or item, the test to be applied is set forth in *Katz*, which asks whether the search or seizure implicates an individual's reasonable expectation of privacy.<sup>179</sup> Specifically, the analysis asks whether there is a reasonable expectation of privacy in the information reported under FATCA requirements.

First, it had been asserted by the Government in the *Crawford* case, that under FATCA, no search exists because FATCA does not actually “require” the FFIs to report the information and “it simply imposes a tax on FFIs that choose not to report certain information.”<sup>180</sup> However, it is clear that FFIs are required to report their client information. As stated by an IRS official, even if a dollar of the withholding tax is not collected, FATCA will be considered a success in its efforts to compel compliance.<sup>181</sup> The withholding tax that is imposed on nonparticipating FFIs was implemented as a way to enforce compliance with reporting requirements. Furthermore, the withholding penalty does not realistically create an option for the FFIs. While it may seem simple on its face to either report the information or pay the withholding tax, the thirty percent

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<sup>178</sup> 26 U.S.C. § 1471(b)(1)(c) (2010).

<sup>179</sup> *Katz v. United States*, 389 U.S. 347 (1967).

<sup>180</sup> Brief for Defendant at 47, *Crawford v. United States Dep't of the Treasury*, No. 3:15-CV-250, 2015 WL 5697552 (S.D. Ohio Sept. 29, 2015).

<sup>181</sup> Bennett, *supra* note 83.

withholding is quite steep, making noncompliance financially impossible for many FFIs to endure.<sup>182</sup>

In concluding that the reporting requirements are, in fact, requirements, it must next be determined whether there is a privacy interest in that information required. While it has been held that bank records do not hold a privacy interest, before assuming this position, a further analysis of the records at hand will lead to the conclusion that there is a privacy interest in the records required by FATCA.<sup>183</sup>

FATCA requires FFIs to report sensitive information of their U.S. account holders, including personal information of the account holder, the account number and balance, as well as the aggregate gross amounts of interests and income paid or credited to the account.<sup>184</sup> This reporting requirement is not like that of a pen register, which only reveals the numbers dialed from a specific phone.<sup>185</sup> Instead, this is sensitive information relating to a person's financial activity. As mentioned in the dissents from both *California Bankers* and *Miller*, bank records can reveal much more personal information than the depositor's financial activity.<sup>186</sup> This is because by looking at bank records such as account statements or checks, one can derive much about a person's personal life based on the items and services paid for through that account. However, while the information reported under FATCA is sensitive information based on

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<sup>182</sup> See, *supra* Part III B 1 for discussion on FFIs inability to pay. Instead of choosing to either a) pay the withholding tax or b) report the required information, many FFIs have created an option c – to drop their U.S. customers altogether.

<sup>183</sup> *United States v. Miller*, 425 U.S. 435 (1976).

<sup>184</sup> 26 U.S.C. § 1471(c) (2010).

<sup>185</sup> See, *Smith v. Maryland*, 442 U.S. 735 (1979).

<sup>186</sup> See, *California Bankers*, 416 U.S. 21 at 85 (Douglas, J., dissenting); See, *also*, *U.S. v. Miller*, 425 U.S. 435 at 449 (Brennan, J., dissenting).

personal financial activity, it is less likely to lead the Government to realize other personal aspects of the individual than would be realized from an individual's bank statement.<sup>187</sup>

It has been held that the Fourth Amendment does not protect information that has been revealed to a third party and conveyed by him to the Government.<sup>188</sup> Under FATCA, individuals reveal their financial information to the banks, which then must report said information to the IRS.<sup>189</sup> However, there is more to the equation at hand than simply entrusting someone with private information in hopes they will not report it. When a customer creates an account at a financial institution, he has the reasonable expectation that the information disclosed is going to be used for bank purposes only, and not to be tracked and recorded for Government purposes.<sup>190</sup> The banker-customer relationship is one that is generally understood as a confidential one.<sup>191</sup> Additionally, in order to participate as a functioning citizen, it is essential to maintain a bank account.<sup>192</sup> However, in order to access a bank account, an individual is required to reveal his personal information.<sup>193</sup> Essentially, citizens are societally forced into maintaining a bank account, but then told that they have voluntarily waived their Fourth Amendment rights by doing so, since it has been held that there is no expectation of privacy in bank records.

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<sup>187</sup> In his dissent, Justice Douglass describes the type of personal information that can be found by viewing an individual's bank statement, which includes the specifics of the checks that the individual writes. *California Bankers*, 416 U.S. 21 at 85 (Douglas, J., dissenting); the information required by FATCA does not require such specific of information. *See* 26 U.S.C. § 1471(c).

<sup>188</sup> *See*, *United States v. White*, 401 U.S. 745, 751-752 (1971). Obtaining information revealed to a third party and conveyed by him to the Government authorities does not violate the Fourth Amendment, even if the information is revealed under the assumption of confidence in the third party.

<sup>189</sup> *See, supra* Part IIIA2.

<sup>190</sup> *See, e.g., Wells Fargo Team Member Handbook*, WELLS FARGO, 41 (July 2015). "Confidentiality has always been an essential part of the financial industry's business. Wells Fargo's customers give us private information about themselves and rightfully trust us to keep this information in confidence. Today, we have technology that enables us to keep more information about customers than ever before. Recognizing this, Wells Fargo has placed special emphasis on the appropriate collection, storage, and use of customer information. Moreover, Wells Fargo has provided team members with access to computers, electronic mail, the intranet, and the internet. This access is a privilege that carries special responsibilities."

<sup>191</sup> *Id.*; *U.S. v. Miller*, 425 U.S. 435 at 449 (Brennan, J., dissenting).

<sup>192</sup> Debbie Dragon, *The Drawbacks of Not Having a Bank Account*, U.S. NEWS, MONEY <http://money.usnews.com/money/blogs/my-money/2012/12/14/the-drawbacks-of-not-having-a-bank-account> (Dec. 14, 2012, 9:36AM).

<sup>193</sup> *See, U.S. v. Miller*, 425 U.S. 435 at 449 (Brennan, J., dissenting).

Finally, the reporting requirements can be compared to the GPS monitoring in *Jones*.<sup>194</sup> FACTA requires FFIs to continuously track their customers, and annually report the information on each U.S. account.<sup>195</sup> The *Jones* concurrence noted that the long-term tracking of the individual contravened his Fourth Amendment right because society would not expect the constant monitoring.<sup>196</sup> While FATCA does not track the geographical movements of individuals, it is a long-term tracking of a person's financial activity as long as they hold a foreign account.<sup>197</sup>

While the required information to be reported by FFIs under FATCA may not reveal the utmost personal characteristics of the individual account holders, there is generally an expectation that account information be kept private in the banker-customer relationship. The compulsory information reporting infringes upon a reasonable expectation of privacy and this must be found reasonable under the Fourth Amendment.<sup>198</sup>

## **2. The Searches are Unreasonable Under the Fourth Amendment**

After assuming that a search has in fact triggered the Fourth Amendment by infringing on an individual's expectation of privacy, the next step of the analysis is to determine whether the search was reasonable. The searches in *California Banking* were considered reasonable because the banks were only required to report certain transactions and they were sufficiently related to criminal, tax, and regulatory investigations.<sup>199</sup> FATCA, however, requires the reporting of all

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<sup>194</sup> United States v. Jones, 132 S.Ct. 945 (2012).

<sup>195</sup> 26 U.S.C. § 1471(b)(1)(C) (2010).

<sup>196</sup> U.S. v. Jones, 132 S.Ct. 945 at 955 (Sotomayor, J., concurring).

<sup>197</sup> FFIs must report the required information annually for as long as the account is held. *See*, 78 Fed. Reg. at 5874.

<sup>198</sup> It should be noted that this information would be available to the government if it were a domestic account under the Bank Secrecy act of 1970. *Bank Secrecy Act*, Internal Revenue Service, <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Bank-Secrecy-Act> (last updated Nov. 9, 2015). However, this note will argue that the reporting requirements of FATCA are unreasonable under the Fourth Amendment in the discussion below.

<sup>199</sup> *California Bankers Ass'n v. Shultz*, 416 U.S. 21, 26 (1974).



U.S. foreign accounts.<sup>200</sup> The FATCA reporting requirements arguably resemble that of a general search warrant. It was enacted in order to curb tax evasion of U.S. citizens using foreign accounts. However, while the information reported can be useful to the IRS in confirming the income reported by individuals, there are no particularized suspicions in collecting this information from every foreign U.S. account. Doing so assumes that every U.S. citizen with a foreign account is a “crook” evading his taxes.<sup>201</sup> Additionally, the searches at hand contain the potential for abuse. This is due to the “access to this information without invocation of the judicial process.”<sup>202</sup> The scrutiny of a neutral magistrate helps to balance societal and individual interests in the collection of the information at hand.<sup>203</sup> Without a warrant issued through the judicial process, the search is an unreasonable violation of the individual account holders’ Fourth Amendment rights.

### 3. Standing

It is worth noting that in order to properly challenge FATCA, an individual must have standing, which is why the constitutional challenge was not discussed further in the *Crawford* case.<sup>204</sup> The court in *Rakas v. Illinois* held that Fourth Amendment rights are “personal in nature” and one does not have standing to challenge the invasion of another’s property or privacy.<sup>205</sup> This brings us to a discussion on the first prong of the *Katz* expectation of privacy test. The above analysis discusses the expectation of privacy of a reasonable person. However,

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<sup>200</sup> The only required “trigger” for the reporting of account information is whether it is a U.S. account at an FFI. *See, generally*, 26 U.S.C. §1471 (2010).

<sup>201</sup> Similar to Justice Douglas stating that every individual’s bank records being useful for criminal, tax, or regulatory investigations is essentially assuming that every person is a crook, FATCA essentially assumes that every U.S. citizen with a foreign bank account is a crook who is trying to evade his taxes. *California Bankers*, 416 U.S. 21 at 85 (Douglas, J., dissenting).

<sup>202</sup> *United States v. Miller*, 425 U.S. 435, 453 (1976) (Brennan, J., dissenting).

<sup>203</sup> *Id.*

<sup>204</sup> *Crawford v. United States Dep’t of the Treasury*, No. 3:15-CV-250, 2015 WL 5697552 (S.D. Ohio Sept. 29, 2015).

<sup>205</sup> *Rakas v. Illinois*, 439 U.S. 128, 140 (2014).

an individual must first prove that he had an actual and subjective expectation of privacy.<sup>206</sup>

Therefore, in order for an individual to have standing to challenge FATCA under the Fourth Amendment, it is first necessary for him to have a foreign financial account at an FFI that then reports the required personal account information to the IRS.

## **V. Tweaking FATCA: A Solution**

If FATCA is upheld as constitutional, does that mean that it is good for U.S. citizens? The automatic reporting by FFIs on individual account holder information infringes upon individuals' protection under the Fourth Amendment by requiring FFIs to report information about its American account holders to the IRS.

A potential solution to ease this problem is to remove the automatic reporting requirement of FFIs. This will bring FATCA closer to the scope of *California Bankers* by requiring FFIS to simply maintain the records.<sup>207</sup> The reporting requirements should still be implemented on the individual level. However, the IRS's receipt of the records from FFIs could be left to the "existing legal process" by requiring the IRS to utilize search warrants for specific accounts.<sup>208</sup> The IRS would be able to cross-check the information reported by individuals with the account information held by the FFIS, while allowing for a neutral magistrate to properly balance the interests of society and the individual on a case-by-case basis. Additionally, this will require a more particularized suspicion before the IRS can receive the information.

This solution may not further the efforts of tax compliance to the extent that the IRS is seeking. It brings with it some of the issues found with the Qualified Intermediary programs with the lack of an automatic reporting. However, the constitutional rights of American citizens

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<sup>206</sup> *Katz v. United States*, 389 U.S. 347, 361 (Harlan, J., concurring).

<sup>207</sup> *See, California Bankers Ass'n v. Shultz*, 416 U.S. 21, 26 (1974). "[W]e hold that mere maintenance of the records by the banks under the compulsion of the regulations invaded no Fourth Amendment right of any depositor."

<sup>208</sup> *Id.*

should be prioritized over the loss of revenue that is caused by only a fraction of those citizens under reach of the statute.<sup>209</sup> Under this regime, the FFIs would still hold the required information for a number of years, and would make it available upon request through the use of a warrant. The IRS would still be able to check on the information being reported by individuals, and in doing so would still be in compliance with the constitutional rights of United States citizens.

## **VI. Conclusion**

The Foreign Account Tax Compliance Act was implemented as a solution to curb offshore tax evasion. However, instead of specifically targeting tax evaders, the strict, automatic reporting requirements have led to a sharp increase in expatriates, and will potentially lead to further setbacks for the U.S. economy and foreign relations. Furthermore, it is arguably unconstitutional as an unreasonable search under the Fourth Amendment.

While there is a significant need to prevent offshore tax evasion in order to increase tax compliance, FATCA is not the proper tool to do so. The burdens of FATCA significantly outweigh the benefits. FATCA generalizes all Americans with foreign accounts and imposes requirements that infringe upon the constitutional rights of U.S. citizens. FATCA should be repealed, or at least modified in a way that better achieves its targets of those U.S. citizens using offshore accounts to evade taxes, while protecting the Fourth Amendment Constitutional rights of U.S. citizens.

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<sup>209</sup> The automatic reporting feature of FATCA is helpful in bringing in lost revenue from those who are evading their taxes through non-reporting. The IRS is getting information of all U.S. accounts, and simply cross-checking the individual's reporting to make sure that they have disclosed their foreign accounts. However, removing the individualized suspicion in this collection of information creates a constitutional violation. Requiring FFIs to maintain the information, but relying on warrants and a reasonable suspicion from the IRS that an individual holds a foreign account will better protect the constitutional rights of U.S. citizens.