Behold FATCA: Treading the Untrodden Path of Extraterritorial Tax Withholding

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I. INTRODUCTION

In the wake of United States (U.S.) President Barack H. Obama's reelection, financial institutions around the world await anxiously how aggressively his administration will be implementing what is probably the most drastic international tax enforcement legislation they have ever seen — the Foreign

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Account Tax Compliance Act (FATCA).[1] Signed into law by President Obama during his first term as part of the Hiring Incentives to Restore Employment (HIRE) Act,[2] FATCA subjects to information reporting and withholding requirements all "U.S. accounts" kept outside the U.S.

In general, the U.S. taxes the worldwide income of its citizens and resident aliens.[3] Recent estimates, however, put the U.S. government's losses in offshore tax evasion at $100 billion a year.[4] FATCA is thus the culmination of the Obama administration's concerted effort to quell offshore tax evasion.

The systemic problem was first discovered when a Switzerland-based banker blew the whistle.

Bradley Birkenfeld, born and raised in the U.S., spent the previous decade mostly as a banker in Switzerland, helping well-off Americans stash their money where the Internal Revenue Service (IRS) would not find it.[5] Armed with inside information and documentation, he came to the U.S. Department of Justice in the Spring of 2007 and disclosed that his former employer, Swiss bank UBS AG (UBS), aided its American clients in evading billions of dollars in taxes — setting off an investigation.[6]

A press release of the U.S. Department of Justice on 18 February 2009 announced that UBS, Switzerland's largest bank, had entered into a deferred prosecution agreement on charges of conspiring to defraud the U.S. by impeding the IRS.[7] In this agreement, complying with an order issued by the Swiss Financial Markets Supervisory Authority, UBS agreed, in an unprecedented move, to provide the U.S. government with the account details of some of its U.S. customers.[8]

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1. Hiring Incentives to Restore Employment Act, Pub. L. No. 111-147, 124 Stat. 71, 97-117 (U.S.).
2. *See* Hiring Incentives to Restore Employment Act, 124 Stat. 71, 71-118.
3. 6 MERTENS LAW OF FEDERAL INCOME TAXATION § 25B-2:54 (2012 ed.).
4. *See* Trevor Cole, How I learned to hide money from the taxman in the shell-company capital of the world, with help from a cabbie named Shorty, a jet-setting fraud investigator and a curious cast of Caribbean bankers, *available at* https://secure.globeadvisor.com/ servlet/ArticleNews/story/ gam/20110128/ROBMAG-FEB11-P44-50 (last accessed Nov. 20, 2012).
5. *See* CBS News, Banking: A Crack In The Swiss Vault, *available at* http://www.cbsnews.com/8301-18560_162-6038169.html (last accessed Nov. 20, 2012).
6. *Id.*
7. *See* The United States Department of Justice, UBS Enters into Deferred Prosecution Agreement, *available at* http://www.justice.gov/opa/pr/2009/February/09-tax-136.html (last accessed Nov. 20, 2012).
8. *Id.*

The U.S. and Zurich-based UBS disagreed, however, as to the number of accounts to disclose to the IRS, resolving to take the matter to court.[9] Thus, only a day after the deferred prosecution agreement was signed, on 19 February 2009, the U.S. government sued UBS in Florida to force the disclosure of about 52,000 accounts.[10]

In mid-August 2009, the Swiss government stepped in and struck a deal with the U.S. government to provide the names attached to 4,450 secret American accounts at UBS.[11] And just like that, the world-renowned, centuries-old Swiss banking secrecy became history.

Ostensibly using its UBS case victory as leverage, the U.S. Department of Justice launched a broader probe against American tax cheats. In June 2010, it opened a criminal investigation into whether some American clients of London-based HSBC Holdings Plc failed to disclose offshore accounts.[12]

To resolve a similar inquiry covering transactions closed over eight years ago, Frankfurt-based Deutsche Bank entered into a non-prosecution agreement in December 2010 to pay the U.S. government $553.6 million as a penalty for participating in fraudulent tax shelters that enabled American clients to hide billions of dollars from the IRS.[13]

Against this backdrop, FATCA was born. With its extensive information and withholding requirements seeking to reach U.S. accounts anywhere in the world, FATCA hopes to render the criminal investigation and prosecution of American tax evaders unnecessary.

That the enactment of FATCA caused quite a stir is not an overstatement.

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9. David Voreacos and Carlyn Kolker, U.S. Sues UBS Seeking Swiss Account Customer Names (Update3), Feb. 19, 2009, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a_TaQP5WVZuA&refer=home (last accessed Nov. 20, 2012).

10. *Id.*

11. Editorial, *If Switzerland Can …*, THE N.Y. TIMES, Aug. 21, 2009, *available at* http://www.nytimes.com/2009/08/22/opinion/22sat1.html?_r=0 (last accessed Nov. 20, 2012).

12. Clare Baldwin and Joe Rauch, HSBC clients scrutinized in U.S. tax evasion probe, *available at* http://www.reuters.com/article/2010/07/07/us-hsbc-idUSTRE66608720100707 (last accessed Nov. 20, 2012).

13. IBTimes Reporter, *Deutsche Bank settles tax shelter case for $553.6 mln*, INT'L BUS. TIMES, Dec. 29, 2010, *available at* http://www.ibtimes.com/deutsche-banksettles-tax-shelter-case-5536-mln-252207# (last accessed Nov. 20, 2012).

Experts say that most banks in Switzerland are quietly ushering American clients out or limiting the range of products offered to them.[14] This may have in part accounted for the sevenfold increase in the number of wealthy American expatriates who renounced their nationality, from 235 in 2008 to approximately 1,780 in 2011.[15] A trend that may be gaining momentum globally, some of the largest wealth-management firms, including HSBC Holdings Plc, Deutsche Bank AG, Bank of Singapore Ltd., and DBS Group Holdings Ltd., are also turning away business from American millionaires.[16]

Despite the potential repercussions, the U.S. Department of the Treasury is engaged in negotiations with more than 50 countries and jurisdictions to implement FATCA.[17] It remains to be seen, however, how many countries in the world will actually cooperate with the U.S. As it is, a financial industry backlash may be in the offing.

This Article prompts an awareness of FATCA in the Philippines, and begins a discussion of some of its important legal implications from a Philippine perspective.

So how does FATCA go about its business?

II. FATCA

FATCA is now Chapter 4 to Subtitle A of the U.S. Internal Revenue Code of 1986 (IRC). This Section outlines some key provisions.

A. In General

FATCA imposes a 30% withholding tax on "withholdable payments" made to foreign financial institutions (FFIs) and non-financial foreign entities

14. Anita Greil, *Wary Swiss Banks Shun Yanks*, WALL ST. J., Oct. 19, 2012, *available at* http://online.wsj.com/article/SB100008723963904445927045780625702955 43436.html (last accessed Nov. 20, 2012).

15. Giles Broom, Wealthy Americans Queue to Give Up Their Passports, *available at* http://www.bloomberg.com/news/2012-05-01/wealthy-americans-queue-to-give-up-passports-in-swiss-capital.html (last accessed Nov. 20, 2012).

16. Sanat Vallikappen, U.S. Millionaires Told Go Away as Tax Evasion Rule Looms, *available at* http://www.bloomberg.com/news/2012-05-08/u-smillio naires-told-go-away-as-tax-evasion-rule-looms.html (last accessed Nov. 20, 2012).

17. *See* U.S. Department of the Treasury, U.S. Engaging with More than 50 Jurisdictions to Curtail Offshore Tax Evasion, *available at* http://www.trea sury.gov/press-center/press-releases/Pages/tg1759.aspx (last accessed Nov. 20, 2012).

(NFFEs), unless certain requirements are met.[18] The term "withholdable payment" means:

(i) any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the [U.S.;] and

(ii) any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the [U.S.][19]

In this regard, an "FFI" is any financial institution which is a foreign entity, which shall not include a financial institution organized under the laws of any possession of the U.S.[20] A "financial institution" is, in turn, any entity that:

(A) accepts deposits in the ordinary course of a banking or similar business[;]

(B) as a substantial portion of its business, holds financial assets for the account of others[;] or

(C) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, ... partnership interests, commodities, ... or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.[21]

On the other hand, an "NFFE" is any foreign entity which is not a financial institution as defined above.[22]

B. FFIs

A 30% withholding tax applies to withholdable payments made to FFIs, unless such FFIs agree:

(A) to obtain such information regarding each holder of each account maintained by such institution as is necessary to determine which (if any) of such accounts are [U.S.] accounts[;]

(B) to comply with such verification and due diligence procedures as the [proper authority] may require with respect to the identification of [U.S.] accounts[;]

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18. I.R.C. § 1471 (a) (2010) (U.S.).

19. *Id.* § 1473 (1) (A).

20. *Id.* § 1471 (d) (4).

21. *Id.* § 1471 (d) (5).

22. *Id.* § 1472 (d).

> (C) in the case of any [U.S.] account maintained by such institution, to report on an annual basis the information described in [S]ubsection (c) with respect to such account[;]
>
> (D) to deduct and withhold a tax equal to 30[%] of[:]
>
> (i) any passthru payment which is made by such institution to a recalcitrant account holder or another [FFI] which does not meet the requirements of this [S]ubsection[;] and
>
> (ii) in the case of any passthru payment which is made by such institution to a [FFI] which has in effect an election under [P]aragraph (3) with respect to such payment, so much of such payment as is allocable to accounts held by recalcitrant account holders or [FFIs] which do not meet the requirements of this [S]ubsection[;]
>
> (E) to comply with requests for additional information with respect to any [U.S.] account maintained by such institution[;] and
>
> (F) in any case in which any foreign law would (but for a waiver described in clause (i)) prevent the reporting of any information referred to in this [S]ubsection or [S]ubsection (c) with respect to any [U.S.] account maintained by such institution[:]
>
> (i) to attempt to obtain a valid and effective waiver of such law from each holder of such account[;] and
>
> (ii) if a waiver described in clause (i) is not obtained from each such holder within a reasonable period of time, to close such account.[23]

An FFI may, however, be deemed to meet the requirements above and not be subject to the 30% withholding tax on withholdable payments if:

> (A) such institution —
>
> (i) complies with ... procedures ... prescribe[d] to ensure that such institution does not maintain [U.S.] accounts[;] and
>
> (ii) meets such other requirements ... prescribe[d] with respect to accounts of other [FFIs] maintained by such institution; or
>
> (B) such institution is a member of a class of institutions with respect to which the [proper authority] has determined that the application of this [S]ection is not necessary to carry out the purposes of this [S]ection.[24]

The meaning of "U.S. account" in the sense of FATCA is explained by Mertens thus —

> A [U.S.] account is any financial account which is held by one or more specified [U.S.] persons or [U.S.] owned foreign entities. Absent an

23. *Id.* § 1471 (b) (1).

24. I.R.C. § 1471 (b) (2).

> election out, a U.S. account does not include any depository account maintained by the FFI if each holder of the account is a natural person, and the aggregate value of all depository accounts held by each holder and maintained by the same financial institution which maintains such account does not exceed $50,000[.00]. For purposes of the $50,000[.00] threshold, financial institutions which are members of the same expanded affiliated group are treated as a single financial institution. Duplicative reporting is not required, and a U.S. account does not include any financial account in a FFI if the account is held by another financial institution which meets the agreement requirements, or if the holder of the account is otherwise subject to information reporting requirements which would make the reporting required by this provision duplicative.[25]

By way of exception, the 30% withholding tax shall not apply to a withholdable payment made to an FFI whose beneficial owner is:

> (1) any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing[;]
>
> (2) any international organization or any wholly owned agency or instrumentality thereof[;]
>
> (3) any foreign central bank of issue[;] or
>
> (4) any other class of persons identified by the [proper authority] for purposes of this [S]ubsection as posing a low risk of tax evasion.[26]

C. NFFEs

The rule for NFFEs is stated thus —

> In the case of any withholdable payment to an [NFFE], if[:]
>
> (1) the beneficial owner of such payment is such entity or any other [NFFE;] and
>
> (2) the requirements of [S]ubsection (b) are not met with respect to such beneficial owner,
>
> then the withholding agent with respect to such payment shall deduct and withhold from such payment a tax equal to 30[%] of the amount of such payment.[27]

The second condition above refers to Subsection (b) of Section 1472 of the IRC (in the FATCA Chapter) — which imposes certain requirements on the beneficial owner of a withholdable payment made to an NFFE, in order to avoid the application of a 30% withholding tax to such payment.

25. 13 MERTENS LAW OF FEDERAL INCOME TAXATION § 47B:88 (2012 ed.) (citing I.R.C. § 1471 (d) (1)).

26. I.R.C. § 1471 (f).

27. *Id.* § 1472 (a).

With respect to the said beneficial owner, these requirements are considered met if:

> (1) such beneficial owner or the payee provides the withholding agent with either[:]
>
> > (A) a certification that such beneficial owner does not have any substantial [US] owners[;] or
> >
> > (B) the name, address, and [taxpayer identification number] of each substantial [US] owner of such beneficial owner[;]
>
> (2) the withholding agent does not know, or have reason to know, that any information provided under [P]aragraph (1) is incorrect[;] and
>
> (3) the withholding agent reports the information provided under [P]aragraph (1) (b) in the manner [prescribed].[28]

But the 30% withholding tax on withholdable payments to NFFEs shall not apply to the following:

> (1) except as otherwise provided by the [proper authority], any payment beneficially owned by[:]
>
> > (A) any corporation the stock of which is regularly traded on an established securities market[;]
> >
> > (B) any corporation which is a member of the same expanded affiliated group ... as a corporation described in [S]ubparagraph (a)[;]
> >
> > (C) any entity which is organized under the laws of a possession of the [U.S.] and which is wholly owned by one or more bona fide residents ... of such possession[;]
> >
> > (D) any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing[;]
> >
> > (E) any international organization or any wholly owned agency or instrumentality thereof[;]
> >
> > (F) any foreign central bank of issue[;] or
> >
> > (G) any other class of persons identified by the [proper authority;] and
>
> (2) any class of payments identified by the [proper authority] as posing a low risk of tax evasion.[29]

III. EXTRATERRITORIAL ENFORCEMENT — U.S. STYLE

The strategy adopted by the U.S. for cross-border enforcement is a so-called "intergovernmental approach" to combating tax evasion, whereby it engages

28. *Id.* § 1472 (b).

29. *Id.* § 1472 (c).

with national governments to obtain commitments on FATCA implementation.[30] The U.S. Department of the Treasury has published model intergovernmental agreements for implementing FATCA, which serve as the basis for executing bilateral agreements with interested jurisdictions.[31]

The U.S. has thus far concluded bilateral agreements to implement FATCA with the United Kingdom,[32] Denmark,[33] and Mexico.[34] These bilateral agreements generally provide for reciprocal obligations to obtain and exchange information annually on "reportable accounts" in financial institutions operating in the reporting jurisdiction belonging to persons taxable in the other jurisdiction, subject to certain conditions.[35]

Additional jurisdictions with which the U.S. is in the process of finalizing an intergovernmental agreement include France, Germany, Italy, Spain, Japan, Switzerland, Canada, Finland, Guernsey, Ireland, Isle of Man, Jersey, the Netherlands, and Norway.[36]

Jurisdictions with which the U.S. is actively engaged in a dialogue towards executing an intergovernmental agreement include Argentina, Australia, Belgium, the Cayman Islands, Cyprus, Estonia, Hungary, Israel,

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30. *See* U.S. Department of the Treasury, *supra* note 17.

31. *Id.*

32. Agreement Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland to Improve International Tax Compliance and to Implement FATCA, U.S.-U.K., Sep. 12, 2012, *available at* http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-UK-9-12-2012.pdf (last accessed Nov. 20, 2012) [hereinafter U.S.-U.K. FATCA Agreement].

33. Agreement Between the Government of the United States of America and the Government of the Kingdom of Denmark to Improve International Tax Compliance and to Implement FATCA, U.S.-Den., Nov. 19, 2012, *available at* http:// www.treasury.gov/ resource-center/ tax-policy/ treaties/ Documents/ FATCA-Agreement-Denmark-11-19-2012.pdf (last accessed Nov. 20, 2012) [hereinafter U.S.-Den. FATCA Agreement].

34. Agreement Between the Department of the Treasury of the United States of America and the Ministry of Finance and Public Credit of the United Mexican States to Improve International Tax Compliance Including with Respect to FATCA, U.S.-Mex., Nov. 19, 2012, *available at* http://www.treasury.gov/ resource-center/tax-policy/treaties/ Documents/ FATCA-Agreement-Mexico-11-19-2012.pdf (last accessed Nov. 20, 2012) [hereinafter U.S.-Mex. FATCA Agreement].

35. *See* U.S.-U.K. FATCA Agreement, *supra* note 32, § 2; U.S.-Den. FATCA Agreement, *supra* note 33, § 2; & U.S.-Mex. FATCA Agreement, *supra* note 34, § 2.

36. *See* U.S. Department of the Treasury, *supra* note 17.

Korea, Liechtenstein, Malaysia, Malta, New Zealand, the Slovak Republic, Singapore, and Sweden.[37] The U.S. also expects that negotiations with several of these jurisdictions will be concluded soon.[38]

IV. LEGAL ISSUES

From a Philippine perspective, here are some of the legal issues on FATCA that stand out.

A. Secrecy of Bank Deposits

To avoid the 30% withholding tax on withholdable payments to it, an FFI must agree to, among other things, report the following information on every U.S. account to the U.S. tax authorities on an annual basis:

> (A) [t]he name, address, and [taxpayer identification number] of each account holder which is a specified U.S. person and, in the case of any account holder which is a U.S. owned foreign entity, the name, address, and TIN of each substantial U.S. owner of such entity[;]
>
> (B) [t]he account number[;]
>
> (C) [t]he account balance or value[;] and
>
> (D) [e]xcept to the extent provided by the [proper authority], the gross receipts and gross withdrawals or payments from the account[.][39]

If an FFI fails to assent to the reporting requirement, it will have to bear the 30% withholding tax on each withholdable payment to it. For FFIs operating in the Philippines that maintain U.S. accounts, opting to report the specified information instead of shouldering the withholding tax will not be an easy decision to make. They will need to mull over a potential run-in with the law on secrecy of bank deposits.

Section 2 of Republic Act (R.A.) No. 1405 reads —

> All deposits of whatever nature with banks or banking institutions in the Philippines including investments in bonds issued by the Government of the Philippines, its political subdivisions and its instrumentalities, are hereby considered as *of an absolutely confidential nature* and may not be examined, inquired, or looked into by any person, government official, bureau, or office, *except* upon written permission of the depositor, or in cases of impeachment, or upon order of a competent court in cases of bribery or

37. *Id.*

38. *Id.*

39. I.R.C. § 1471 (c) (1).

> dereliction of duty of public officials, or in cases where the money deposited or invested is the subject matter of the litigation.[40]

This appears to be a strong statement of a State policy to afford absolute confidentiality to bank deposits, unless one of the expressly enumerated exceptions obtains. Any violation of the rule on confidentiality will subject the offender, upon conviction, to imprisonment or a fine, or both.[41]

In *Marquez v. Desierto*,[42] on the question whether the order of the Ombudsman to have an *in camera* inspection of the questioned bank account is allowed as an exception to the law on secrecy of bank deposits, the Supreme Court held —

> An examination of the secrecy of bank deposits law (R.A. No. 1405) would reveal the following exceptions:
>
> (1) Where the depositor consents in writing;
>
> (2) Impeachment case;
>
> (3) By court order in bribery or dereliction of duty cases against public officials;
>
> (4) Deposit is subject of litigation;
>
> (5) Sec. 8, R. A. No. 3019, in cases of unexplained wealth as held in the case of [*PNB vs. Gancayco*].
>
> The order of the Ombudsman to produce for *in camera* inspection the subject accounts with the Union Bank of the Philippines, Julia Vargas Branch, is based on a pending investigation at the Office of the Ombudsman against Amado Lagdameo, et al.[,] for violation of R.A. No. 3019, Sec. 3 (e) and (g) relative to the Joint Venture Agreement between the Public Estates Authority and AMARI.
>
> We rule that before an *in camera* inspection may be allowed, there must be a pending case before a court of competent jurisdiction. Further, the account must be clearly identified, the inspection limited to the subject matter of the pending case before the court of competent jurisdiction. The bank personnel and the account holder must be notified to be present during the inspection, and such inspection may cover only the account identified in the pending case.
>
> ...
>
> In the case at bar, there is yet no pending litigation before any court of competent authority. What is existing is an investigation by the Office of the Ombudsman. In short, what the Office of the Ombudsman would wish

40. An Act Prohibiting Disclosure of or Inquiry into, Deposits with Any Banking Institution and Providing Penalty Therefor, Republic Act No. 1405, § 2 (1955) (emphases supplied).

41. *Id.* § 5.

42. Marquez v. Desierto, 359 SCRA 772 (2001).

> to do is to fish for additional evidence to formally charge Amado Lagdameo, et al., with the Sandiganbayan. Clearly, there was no pending case in court which would warrant the opening of the bank account for inspection.[43]

Also instructive is the pronouncement of the Supreme Court in *Republic v. Eugenio, Jr.*[44] —

> [W]e can assert there is a right to privacy governing bank accounts in the Philippines, and that such right finds application to the case at bar. The source of such right is statutory, expressed as it is in R.A. No. 1405 otherwise known as the Bank Secrecy Act of 1955.
>
> ...
>
> Because of the Bank Secrecy Act, the confidentiality of bank deposits remains a basic [S]tate policy in the Philippines. Subsequent laws, including the AMLA, may have added exceptions to the Bank Secrecy Act, yet the secrecy of bank deposits still lies as the general rule. It falls within the zones of privacy recognized by our laws. The framers of the 1987 Constitution likewise recognized that bank accounts are not covered by either the right to information under Section 7, Article III or under the requirement of full public disclosure under Section 28, Article II. Unless the Bank Secrecy Act is repealed or amended, the legal order is obliged to conserve the absolutely confidential nature of Philippine bank deposits.
>
> Any exception to the rule of absolute confidentiality must be specifically legislated.[45]

The foregoing Supreme Court decisions demonstrate that the exceptions to the rule on secrecy of bank deposits are strictly construed. *Eugenio, Jr.* states emphatically that any exception to the rule of absolute confidentiality of bank deposits must be specifically legislated.[46] Thus, depositors in Philippine banks have a reasonable expectation of privacy with respect to their deposits.

FATCA may not constitute a specifically legislated exception to the rule of banking secrecy because it is not an act of the Philippine Congress. R.A. No. 10021,[47] however, appears to suggest that the Philippine government

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43. *Id.* at 780-82.
44. Republic v. Eugenio, Jr., 545 SCRA 384 (2008).
45. *Id.* at 413-15.
46. *Id.* at 415.
47. An Act to Allow the Exchange of Information by the Bureau of Internal Revenue of Tax Matters Pursuant to Internationally-Agreed Tax Standards, Amending Sections 6 (F), 71 and 270 of the National Internal Revenue Code of 1997, as amended, and for Other Purposes, Republic Act No. 10021 (2010).

may enter into a bilateral agreement with other countries for the purpose of exchanging information on taxpayer bank accounts.

Section 3 of R.A. No. 10021 provides:

> Section 3. Authority of the Commissioner of Internal Revenue to Inquire into Bank Deposit Accounts and Related Information Held by Financial Institutions. — Section 6 (F) of Republic Act No. 8424, as amended, otherwise known as the National Revenue Code of 1997, as amended, is hereby further amended to read as follows:
>
> > SEC. 6. Power of the Commissioner to Make Assessments and Prescribe Additional Requirements for Tax Administration and Enforcement. —
> >
> > ...
> >
> > (F) Authority of the Commissioner to Inquire into Bank Deposit Accounts and Other Related Information Held by Financial Institutions. — Notwithstanding any contrary provision of Republic Act No. 1405, Republic Act No. 6426, otherwise known as the Foreign Currency Deposit Act of the Philippines, and other general and special laws, the Commissioner is hereby authorized to inquire into the bank deposits and other related information held by financial institutions of:
> >
> > (1) A decedent to determine his gross estate.[;]
> >
> > (2) Any taxpayer who has filed an application for compromise of his tax liability under Sec. 204 (A) (2) reason of financial incapacity to pay his tax liability.
> >
> > In case a taxpayer files an application to compromise the payment of his tax liabilities on his claim that his financial position demonstrates a clear inability to pay the tax assessed, his application shall not be considered unless and until he waives in writing his privilege under Republic Act No. 1405, Republic Act No. 6426, otherwise known as the Foreign Currency Deposit Act of the Philippines, or under other general or special laws, and such waiver shall constitute the authority of the Commissioner to inquire into the bank deposits of the taxpayer[; or]
> >
> > (3) A specific taxpayer or taxpayers subject of a request for the supply of tax information from a foreign tax authority pursuant to an international convention or agreement on tax matters to which the Philippines is a signatory or a party of: Provided, That the information obtained from the banks and other financial institutions may be used by the Bureau of Internal Revenue for tax assessment, verification, audit[,] and enforcement purposes.
> >
> > In case of request from a foreign tax authority for tax information held by banks and financial institutions, the exchange of information shall be

done in a secure manner to ensure confidentiality thereof under such rules and regulations as may be promulgated by the Secretary of Finance, upon recommendation of the Commissioner.

The Commissioner shall provide the tax information obtained from banks and financial institutions pursuant to a convention or agreement upon request of the foreign tax authority when such requesting foreign tax authority has provided the following information to demonstrate the foreseeable relevance of the information to the request:

(a) The identity of the person under examination or investigation;

(b) A statement of the information being sought including its nature and the form in which the said foreign tax authority prefers to receive the information from the Commissioner;

(c) The tax purpose for which the information is being sought;

(d) Grounds for believing that the information requested is held in the Philippines or is in the possession or control of a person within the jurisdiction of the Philippines;

(e) To the extent known, the name and address of any person believed to be in possession of the requested information;

(f) A [s]tatement that the request is in conformity with the law and administrative practices of the said foreign tax authority, such that if the requested information was within the jurisdiction of the said foreign tax authority then it would be able to obtain the information under its law or in the normal course of administrative practice and that it is [in] conformity with a convention or international agreement; and

(g) A statement that the requesting foreign tax authority has exhausted all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties.

The Commissioner shall forward the information as promptly as possible to the requesting foreign tax authority. To ensure a prompt response, the Commissioner shall confirm receipt of a request in writing to the requesting tax authority and shall notify the latter of deficiencies in the request, if any, within sixty (60) days from the receipt of the request.

If the Commissioner is unable to obtain and provide the information within ninety (90) days from the receipt of the request, due to obstacles encountered in furnishing the information or when the bank or financial institution refuses to furnish the information, he shall immediately inform the requesting tax authority of the same, explaining the nature of the obstacles encountered or the reasons of refusal.

> The term 'foreign tax authority[,'] as used herein, shall refer to the tax authority or tax administration of the requesting State under the tax treaty or convention to which the Philippines is a signatory or a party of.[48]

The above provision authorizes the Commissioner of Internal Revenue to inquire into bank deposits held by financial institutions belonging to taxpayers who are the subject of a request for the supply of tax information from a foreign tax authority, pursuant to an international convention or agreement on tax matters signed by the Philippine government. At first glance, it is easy to conclude that a bilateral agreement between the Philippine government and the U.S. government to implement FATCA will create a new exception to the rule of banking secrecy.[49]

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48. *Id.* § 3.

49. *See also* R.A. No. 10021, § 5. It provides —

> Section 5. *Authority of the Commissioner of Internal Revenue to Supply Information to a Foreign Tax Authority Which is at his Disposal.* — Section 270 of Republic Act No. 8424, as amended, otherwise known as the National Internal Revenue of 1997, is hereby amended to read as follows:
>
> > SEC. 270. Unlawful Divulgence of Information. — Except as provided in Sections 6 (F) and 71 of this Code and Section 26 of Republic Act No. 6388, any officer or employee of the Bureau of Internal Revenue who divulges to any person or makes known in any other manner than may be provided by law information regarding the business, income, or estate of any taxpayer, the secrets, operation, style or work, or apparatus of any manufacturer or producer, or confidential information regarding the business of any taxpayer, knowledge of which was acquired by him in the discharge of his official duties, shall, upon conviction for each act or omission, be punished by a fine of not less than Fifty thousand pesos (₱50,000) but not more than One hundred thousand pesos (₱100,000), or suffer imprisonment of not less than two (2) years but not more than five (5) years, or both.
> >
> > Any officer or employee of the Bureau of Internal Revenue who divulges or makes known in any other manner to any person other than the requesting foreign tax authority information obtained from banks and financial institutions pursuant to Section 6 (F), knowledge or information acquired by him in the discharge of his official duties, shall, upon conviction, be punished by a fine of not less than Fifty thousand pesos (₱50,000) but not more than One hundred thousand pesos (₱100,000), or suffer imprisonment of not less than two (2) years but not more than five (5) years, or both.

Id.

Precedents, however, seem to point in the opposite direction — the rule of banking secrecy remains guarded zealously in this jurisdiction. The Supreme Court has consistently ruled that bank deposits are statutorily protected and fall within recognized zones of privacy.[50] In *BSB Group, Inc. v. Go*,[51] the Court stated categorically that —

> R.A. No. 1405 has two allied purposes. It hopes to discourage private hoarding and at the same time encourage the people to deposit their money in banking institutions, so that it may be utilized by way of authorized loans and thereby assist in economic development. Owing to this piece of legislation, the confidentiality of bank deposits remains to be a basic state policy in the Philippines.
>
> ...
>
> Subsequent statutory enactments have expanded the list of exceptions to this policy yet the secrecy of bank deposits still lies as the general rule, falling as it does within the legally recognized zones of privacy. There is, in fact, much disfavor to construing these primary and supplemental exceptions in a manner that would authorize unbridled discretion, whether governmental or otherwise, in utilizing these exceptions as authority for unwarranted inquiry into bank accounts. It is then perceivable that the present legal order is obliged to conserve the absolutely confidential nature of bank deposits.[52]

In a legal order that is obliged to conserve the absolutely confidential nature of bank deposits, it is uncertain whether a bilateral agreement to implement FATCA will create an exception to the rule of banking secrecy. It is questionable whether such an agreement, whose enforceability may only be anchored on R.A. No. 10021, barring a Senate ratification that transforms it into a treaty, can sanction a departure from the rule of banking secrecy, which may have its roots in the right to privacy. In fact, if as held in *Eugenio, Jr.*, there is a right to privacy governing bank accounts in the Philippines, then even with Senate ratification, there may still be constitutional imperatives that must be balanced with legitimate government objectives.

B. Philippines-U.S. Tax Treaty

A reading of the Philippines-U.S. Tax Treaty[53] *vis-à-vis* FATCA reveals an apparent conflict on two main points, *viz*: (1) information requirements and (2) tax rates.

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50. BSB Group, Inc. v. Go, 612 SCRA 596 (2010); People v. Estrada, 583 SCRA 302 (2009); *Marquez*, 359 SCRA at 772; & Ople v. Torres, 293 SCRA 141 (1998).

51. *BSB Group, Inc.*, 612 SCRA at 596.

52. *Id.* at 609-10.

53. Convention Between the Government of the United States of America and the Government of the Republic of the Philippines with Respect to Taxes on

On the one hand, with respect to information requirements, Article 26 of the Philippines-US Tax Treaty provides for an exchange of information between the Philippine government and the U.S. government. It reads:

> (1) The competent authorities shall exchange such information as is necessary for carrying out the provisions of this Convention or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which this Convention applies provided the information is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.
>
> (2) Any information so exchanged shall be treated as secret, except that such information may be —
>
> (a) Disclosed to any person concerned with, or
>
> (b) Made part of a public record with respect to the assessment, collection, or enforcement of, or litigation with respect to, the taxes to which this Convention applies.
>
> (3) No information shall be exchanged which would be contrary to public policy.
>
> (4) If information is requested by a Contracting State in accordance with this article, the other Contracting State shall obtain the information to which the request relates from or with respect to its residents or corporations in the same manner and to the same extent as if the tax of the requesting State were the tax of the other State and were being imposed by that other State. A Contracting State may obtain information from or with respect to its residents or corporations in accordance with this [P]aragraph for the sole purpose of assisting the other Contracting State in the determination of the taxes of that other [S]tate.
>
> (5) If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this article in the form of depositions of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts, or writings) to the same extent such depositions and documents can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.
>
> (6) The exchange of information shall be either on a routine basis or on request with reference to particular cases. The competent authorities of the Contracting States may agree on the list of information which shall be furnished on a routine basis.[54]

Income, Phil.-U.S., Oct. 1, 1976, 34 U.S.T. 1277 (entered into force Oct. 16, 1982) [hereinafter Phil.-U.S. Income Tax Treaty].

54. *Id.* art. 26.

On the other hand, under FATCA, as reflected earlier, to avoid the 30% withholding tax on withholdable payments to it, an FFI must agree to, among other things, report the following information on every U.S. account to the U.S. tax authorities on an annual basis:

> (A) [t]he name, address, and [taxpayer identification number] of each account holder which is a specified U.S. person and, in the case of any account holder which is a U.S. owned foreign entity, the name, address, and TIN of each substantial U.S. owner of such entity[;]
>
> (B) [t]he account number[;]
>
> (C) [t]he account balance or value[;] and
>
> (D) [e]xcept to the extent provided by the [proper authority], the gross receipts and gross withdrawals or payments from the account[.][55]

From the foregoing, it seems that the exchange of information scheme under the Philippines-U.S. Tax Treaty is far less onerous and intrusive than the information requirements of FATCA.

Article 26 (1) of the Philippines-U.S. Tax Treaty limits the exchange of information to information that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.[56] Article 26 (3) states further that no information shall be exchanged which would be contrary to public policy.[57] Thus, the exchange of information under the Philippines-U.S. Tax Treaty respects local prohibitions on information disclosure, such as the secrecy of bank deposits.

In contrast, under FATCA, an FFI receiving a withholdable payment must commit to report to U.S. tax authorities detailed information on each U.S. account, including the account balance and gross receipts and payments from the account.[58] Failure to comply makes the withholdable payment to the relevant FFI subject to a 30% withholding tax.[59] No exception is provided in favor of banking secrecy.

On the applicable tax rates, a 30% withholding tax is imposed by FATCA on withholdable payments if the relevant FFI or NFFE does not meet the requirements, regardless of any applicable preferential tax treaty rates on certain categories of income.[60] The Philippines-U.S. Tax Treaty, on

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55. I.R.C. § 1471 (c) (1).

56. Phil.-U.S. Income Tax Treaty, *supra* note 53, art. 26 (1).

57. *Id.* art. 26 (3).

58. *See* I.R.C. § 1471 (b) & (c).

59. *Id.*

60. *Id.* §§ 1471 (b) & (c) & 1472 (b).

the other hand, provides lower tax rates for, among other things, interests and dividends.[61]

The question then is whether FATCA intends to override the Philippine-U.S. Tax Treaty.

Under the fundamental principle of *pacta sunt servanda* in international law, "[e]very treaty in force is binding upon the parties to it and must be performed by them in good faith."[62] Implementing FATCA without a valid tax treaty override will thus result in the U.S. failing to perform a binding tax treaty and thus breaching *pacta sunt servanda.*

An implied treaty override by FATCA may lie latent in the last-in-time policy of the U.S. on conflicts between a tax treaty and an internal law. As early as *Whitney v. Robertson*,[63] the U.S. Supreme Court held —

> By the constitution, a treaty is placed on the same footing, and made of like obligation, with an act of legislation. Both are declared by that instrument to be the supreme law of the land, and no superior efficacy is given to either over the other. When the two relate to the same subject, the courts will always endeavor to construe them so as to give effect to both, if that can be done without violating the language of either; but, if the two are inconsistent, the one last in date will control the other: provided, always, the stipulation of the treaty on the subject is self-executing.[64]

Thus, in a conflict between a tax treaty and an act of the U.S. Congress, the U.S. policy is to uphold the one created last in time. The last-in-time rule may, however, have little effect outside the U.S. Under international law, a state party may not invoke the provisions of its internal law as justification for its failure to perform a treaty.[65]

Will the U.S. nonetheless insist on applying the last-in-time rule to conflicts between FATCA and U.S. tax treaties? Its "intergovernmental approach" to FATCA enforcement probably indicates that it is so inclined. This strategy may be animated by the idea that when national governments accede to bilateral agreements to implement FATCA, they also thereby agree to supersede existing tax treaties with the U.S. If this is the case, a corollary issue would then be whether a bilateral agreement not ratified by the Philippine Senate can supersede a treaty.

61. Phil.-U.S. Income Tax Treaty, *supra* note 53, arts. 11 & 12.

62. Vienna Convention on the Laws of Treaties art. 26, *opened for signature* May 23, 1969, 1155 U.N.T.S. 331.

63. Whitney v. Robertson, 124 U.S. 190 (1888).

64. *Id.* at 194.

65. Vienna Convention on the Laws of Treaties, *supra* note 62, art. 27.

Moreover, if the bilateral agreement implementing FATCA does not expressly modify nor validly supersede the Philippines-U.S. Tax Treaty, then both may remain effective yet conflicting.

C. Power to Conclude Bilateral Agreements

Since the U.S. pursues FATCA implementation by concluding bilateral agreements with national governments, another question that ensues is whether the Philippine government may legally contract away individual rights that may be prejudiced by FATCA, such as the right to privacy.

To reiterate, in *Eugenio, Jr.*, the Supreme Court held —

> [W]e can assert there is a right to privacy governing bank accounts in the Philippines, and that such right finds application to the case at bar. The source of such right is statutory, expressed as it is in R.A. No. 1405 otherwise known as the Bank Secrecy Act of 1955.
>
> ...
>
> Because of the Bank Secrecy Act, the confidentiality of bank deposits remains a basic [S]tate policy in the Philippines. Subsequent laws, including the AMLA, may have added exceptions to the Bank Secrecy Act, yet the secrecy of bank deposits still lies as the general rule. It falls within the zones of privacy recognized by our laws. The framers of the 1987 Constitution likewise recognized that bank accounts are not covered by either the right to information under Section 7, Article III or under the requirement of full public disclosure under Section 28, Article II. Unless the Bank Secrecy Act is repealed or amended, the legal order is obliged to conserve the absolutely confidential nature of Philippine bank deposits.
>
> Any exception to the rule of absolute confidentiality must be specifically legislated.[66]

By recognizing a right to privacy in bank deposits, the Court may be implying in *Eugenio, Jr.* that the rule on secrecy of bank deposits has constitutional underpinnings. The Court even goes as far as to say that "the framers of the 1987 Constitution likewise recognized that bank accounts are not covered by either the right to information under Section 7, Article III or under the requirement of full public disclosure under Section 28, Article II."[67]

As reflected earlier, the Supreme Court has likewise consistently ruled that bank deposits are statutorily protected and fall within recognized zones of privacy.[68] In *BSB Group, Inc.*, the Court further held that "in any given jurisdiction where the right of privacy extends its scope to include an

66. *Eugenio, Jr.*, 545 SCRA at 413-15.

67. *Id.* at 414-15.

68. *BSB Group, Inc.*, 612 SCRA at 596; *Estrada*, 583 SCRA at 302; *Marquez*, 359 SCRA at 772; & *Ople*, 293 SCRA at 141.

individual's financial privacy rights and personal financial matters, there is an intermediate or heightened scrutiny given by courts and legislators to laws infringing such rights."[69]

If the right to privacy that inheres in the secrecy of bank deposits is indeed constitutionally founded, then the "intergovernmental approach" of the U.S. may not be enough to sidestep FATCA's possible infringement of banking secrecy in the Philippines. Again, does the Philippine government have the power to conclude a bilateral agreement that implements a foreign law which may violate a possibly constitutionally protected right to privacy?

V. CONCLUSION

Now more than ever, when even first-world economies are falling like dominoes, tax collection becomes a priority of national governments the world over. But to what extent may cash-strapped States resort to radical legal measures to increase tax collection? FATCA certainly tests the limits of a nation's power to tax.

Still a work in progress, FATCA has a long way to go in terms of making its design and strategy legally viable in foreign jurisdictions. On this score, the "intergovernmental approach" of the U.S. falls short: a *quid pro quo* does not cut it.

Bilateral agreements, where national governments commit to implement FATCA on the basis of mutual concessions, do not automatically make FATCA implementation entirely legal — even in those acceding jurisdictions. Legal shortcuts at best, these agreements, in large part, only serve to shift the blame to the consenting national governments for any illegality resulting from FATCA enforcement.

It is doubtful whether a bilateral agreement to implement FATCA will survive a constitutional challenge in the Philippine Supreme Court. It is far too established to require citation of authority that an international agreement cannot override the Philippine Constitution.

In line with this Article's stated objective, it is hoped that the issues herein raised will trigger further inquiry into the legal implications of FATCA.

69. *BSB Group, Inc.*, 612 SCRA at 614 (citing 16B AM. JUR. 2D § 605 73-74).