FATCA AND COMMON REPORTING STANDARD: THE END OF THE ERA OF BANK SECRECY

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ABSTRACT

In the conditions of the formation of the information society doctrine, the study of the applicability of such an institution as bank secrecy becomes an urgent topic for research. However, the interpretation of this category of banking, like many others, today differs from the traditional one.

The first significant attack on the institution of banking secrecy began with a campaign organized by Washington to combat the so-called "international terrorism". The second event (financial crisis) exposed such a financial problem as tax evasion of individuals and legal entities. An even more powerful tool to erode bank secrecy followed - the US Foreign Investment Tax Compliance Act (FATCA). Since 2012, similar work has begun in the OECD countries to develop standards for the automatic exchange of financial information for tax purposes (Common Reporting Standard, CRS). In practice, this agreement means the end of the era of bank secrecy, which lasted more than 300 years.

The Russian Federation has joined these international programs. Following the results of 2018, the organizations of the financial market of the Russian Federation should send their first reports under this system in 2019.

From the point of view of tradition, the considered legal acts obviously invade the private sphere of relations between the bank and the client, regulated by the agreement on opening a bank account and bank deposit, in the interests of the fiscal authorities. If the scope of state support is constantly diminishing, then civil society itself must become an apologist for banking secrecy, otherwise, it will lose one of the pillars of autonomous law.

In the paper concern critical problems, which constitute global challenges to the definition and preservation of the institution of bank secrecy. The research methods applied in the paper are based on the study of the literature on the subject.

Keywords: *bank secrecy, loss of confidence in banks, Foreign Account Tax Compliance Act, Common Reporting Standard*

INTRODUCTION

The modern world finance system is a significant factor in the evolution of human civilization. Back in the 1950-1960-ies the majority of economists considered financial institutions as something secondary for the economic development and well-being of the nation. In the neoclassical theory of general equilibrium financial institutions simply had no place. Practically the same can be said about the theories of economic growth (Neo-Keynesian in the traditions of Harrod - Domar or neoclassical ones in the spirit of the Solow - Swan model) [1]. There "capital" is not the financial resources, but physical assets. This one-sided approach reflected the realities of the economy in the first half of the XX.

Today it can be noted that the modern economy is a financial economy, where the financial system is the main object of the state's regulation. In the conditions of the formation of the information society doctrine, the study of the applicability of such an institution as bank secrecy becomes an urgent topic for research. However, the interpretation of this category of banking, like many others, today differs from the traditional one.

METHODOLOGY

The role of the financial system in a modern economy

The rapid development of financial markets in the last two decades of the XX century contributed to the increased interest of the scientific community to the role of the financial system in the economy, the mechanisms of its impact on economic growth, the reasons for the differences in the levels of development of financial systems and their structure in different countries.

The financial system in this paper refers to the system of economic relations and institutions associated with the redistribution of cash savings between lenders and borrowers (in the macroeconomic significance of these terms, ie, between the economic actors who have a free cash flow, and economic actors who are experiencing cash requirements). For example, R. Goldsmith, determines the financial system (using the term of financial structure) as a set of financial instruments, markets and institutions [2]. F. Mishkin understands the financial system set of financial institutions: banks, finance companies, insurance companies, etc. [3]

Financial market institutions belong to the so-called tertiary sector of the economy (or services). It is known that in a number of developing countries the tertiary sectors are growing faster than other sectors: in the mid-1980s in developed countries of OECD the share of services in employment and GDP was 55-65%, and by the end of the first decade of this century it has increased, reaching 65-75%. In most developed countries financial and business services sectors generate 20 to 30% of GDP (actually in financial - 8%, in Russia - 4%). The financial sector share in the produced GDP is significantly higher than its share in the structure of employment, which is obviously due to higher income in this industry [4].

The global financial and economic crisis of 2007-2009 highlighted the need to reform the global financial system and to strengthen coordination between national regulators. The new reality associated with the crisis has revealed the inadequacy of existing mechanisms. In response to the challenges became the revitalization of a number of international forums and organizations, the expansion of the number of participants.

It is the financial system and financial markets were in the middle of this crisis (and to a very large extent provoked it), and not by accident their reform and "readjustment" were discussed at the meetings of the State Heads and Governments of the "Group of Twenty". By the way, this fact is very clear evidence of the role of the financial sector in the modern economy. It can be noted that the modern economy is a financial economy, where the financial system is the main object of the state's regulation.

The role of the financial system is a consequence of the economic development of its functions. There are different classifications of functions of a financial system.

Ross Levine identifies five functions of financial system [7]:

1). information (providing information on possible investments and capital allocation);

2). control and monitoring (monitoring of investments after providing financing);

3). risk management (reduction, diversification and risk management);

4). savings accumulation (mobilization of savings of economic agents);

5). reduction of distribution costs (facilitates the exchange of goods and services)

Robert C. Merton and Zvi Body identify six basic functions of the financial system [5]:

Function 1: Clearing and Settling Payments;

Function 2: Pooling Resources and Subdividing Shares;

Function 3: Transferring Resources across Time and Space;

Function 4: Managing Risk;

Function 5: Providing Information;

Function 6: Dealing with Incentive Problems.

Financial system is unable to perform these functions, if it does not perform the main of them. Robert Merton and Z. Body considered that the main function is temporary, inter-sectoral and inter-country transferring economic resources.

THEORY

Institute of bank secrecy: the concept and problems of its practical application

In the conditions of the formation of the information society doctrine, the study of the applicability of such an institution as bank secrecy becomes an urgent topic for research. However, the interpretation of this category of banking, like many others, today differs from the traditional one.

Although banking secrecy operated in ancient Greece, its first legislative regulation was recorded in Switzerland in 1713. Later, other countries adopted their own acts regulating banking secrecy, which in many respects repeated the aforementioned Swiss law.

Representatives of the classical school saw in this legal institution, first of all, the mechanism of ensuring client confidence in the bank in the interests of concentrating considerable monetary capital in the banking sector. At the same time, banking secrecy itself was understood to mean “the protection of banking operations from accounting by financial bodies, which was carried out for the purpose of taxation” [6]. After all, the banking system redistributes money in the economy, increasing capitalization in the most promising sectors of the economy. As a result, this leads to an increase in GDP and fiscal results [5], [7]. The loss of

confidence in banks due to the violation of the regime of bank secrecy entails irreversible consequences of a public nature. And fiscal transparency can only reduce the administrative costs of financial institutions but does not guarantee high revenues for the state budget.

In discussions about banking secrecy, internal political conflicts of interests of various executive bodies are exposed. This is what encourages the legislator to adopt new legal acts that narrow the term “banking secrecy” and impair the capabilities of clients of credit institutions and the banking system as a whole.

The first significant attack on the institution of banking secrecy began with a campaign organized by Washington to combat the so-called "international terrorism". The law, called the Patriot Act [8], adopted shortly after September 11, 2001, already in 2002, provided the US intelligence agencies with full access to the once-confidential banking information in America without special permits from the prosecutor's office and the judiciary.

The second event (financial crisis) exposed such a financial problem as tax evasion of individuals and legal entities. The American tax system is complicated, and tax rates are high. This led to the fact that successful companies, mainly representatives of the IT industry, chose the jurisdiction of other countries where tax regimes were more favourable. The financial crisis gave impetus to the beginning of an active struggle against offshore and bank secrecy.

This was followed by an even more powerful tool for breaking bank secrecy. In order to increase the volume of tax revenues in 2010, the American Law FATCA (Foreign Account Tax Compliance Act) was adopted, the purpose of which was to prevent individuals and legal entities working and residing in other states from avoiding tax payments [9]. It requires banks in all countries to submit to the US tax authorities’ information about customers that fall under the category of “US taxpayer”. In fact, the FATCA law can be qualified as an attempt by Washington’s direct demand on banks from all countries of the world to eliminate bank secrecy.

Of course, behind official statements, as always, there is an unclaimed goal. And such a goal is the establishment by Washington of direct control over the global financial and banking system.

Since 2012, similar work has begun in the OECD countries to develop standards for the automatic exchange of financial information for tax purposes (Common Reporting Standard, CRS) [10]. As part of the CRS, information for automatic exchange will be required to disclose:

- banks;
- pension funds;
- insurance companies;
- financial organizations;
- investment companies;
- companies whose substantial part of activities is the provision of services of a nominal holder of financial assets;
- investment trusts;
- investment advisors and investment managers.

The exchange of information in the FATCA format is much broader than the exchange of information that was provided for in the EU countries before the adoption of CRS. According to the agreements concluded between the EU member states and the USA, banks and other financial institutions are obliged to transfer any information in their jurisdiction on individuals

and legal entities to the US Tax Administration (IRS). The purpose of adopting a new standard in the EU was to expand the scope of information to be automatically exchanged. This applies to dividends, capital gains, any types of income and account balances held in any bank or other financial institution in respect of any direct, indirect or actual owner. The absence of bank secrecy in the presence of automatic exchange of information will be applied in the broadest form.

RESULTS AND DISCUSSION

The Russian Federation has joined these international programs. Following the results of 2018, the organizations of the financial market of the Russian Federation should send their first reports under this system in 2019.

The current state of banking legislation reveals the absence of a systematic approach to the content, institution, and application of bank secrecy. Any considerations of a political and economic nature allow the legislator to impose further restrictions. The content of the term "bank secrecy" is very vague; the Russian legislator has not defined the purpose of introducing this institution.

The Civil Code of the Russian Federation, giving the concept of "bank secrecy", includes in it the secret of a bank account and bank deposit, account transactions and customer information [11]. The Federal Law "On Banks and Banking" includes in the concept of "banking secrecy" secrecy about transactions, accounts and deposits of its clients and correspondents [12]. Thus, it can be concluded that the concepts of "bank secrecy" in these fundamental legal acts do not coincide.

One of the hallmarks of a democratic society is the expectation of privacy, an integral part of which is the secret of a bank deposit and a bank account. Bank secrecy should be protected as much as possible from access by third parties. At the same time, the information constituting bank secrecy should not be used to damage the state. There is a conflict of interest between the interests of bank customers, on the one hand, and the state represented by the authorities, on the other.

The procedure for providing the above information to the competent authorities should protect the information provided from access by other persons and be regulated in detail.

According to the law, in the event of a bank disclosing information constituting a banking secret, a client (whose rights are violated) has the right to demand compensation from the bank for losses caused to it. In connection with the above, it is important that the information constituting bank secrecy is not provided to persons who do not have the right to receive it, and in this connection, the credit institution is not damaged.

Under the new rules of automatic information, exchange are subject to:

- most financial accounts of individuals;
- financial accounts of legal entities (under certain conditions);
- all newly opened accounts and accounts opened on the date of the introduction of CRS (with some exceptions).

For all individuals and legal entities, clients of banks, the planned changes concerning bank secrecy have already made significant adjustments to the current work with accounts. For

example, it has become much more difficult to open new accounts - banks ask for more detailed information about the beneficial owners of the account; about the company that opens the account; about the scheme of transactions conducted through the account; about the origin of funds and the structure of account management. Bank requirements are increased if the account owner or company for some reason cannot provide a more complete picture of its assets. After opening an account, all financial transactions in bank accounts are tracked very carefully.

From the point of view of tradition, the considered legal acts obviously invade the private sphere of relations between the bank and the client, regulated by the agreement on opening a bank account and bank deposit, in the interests of the fiscal authorities. If the scope of state support is constantly diminishing, then civil society itself must become an apologist for banking secrecy, otherwise, it will lose one of the pillars of autonomous law.

In practice, this agreement means the end of the era of bank secrecy, which lasted more than 300 years.

CONCLUSION

The considered legal acts obviously invade the private sphere of relations between the bank and its clients, which is governed by the agreement on opening a bank account and bank deposit. This is done primarily in the interests of the fiscal authorities.

Under the new rules of automatic information exchange are subject to:

- most financial accounts of individuals;
- financial accounts of legal entities (under certain conditions);
- all newly opened accounts and accounts opened on the date of the introduction of CRS (with some exceptions).

Thus, the inclusion of the Russian Federation in the Multilateral Agreement is the most significant recent initiative aimed at financial control of legal entities and individuals living and working outside the country.

In a civil society, the private sphere should be provided with legal measures of state protection, on the one hand, and active reaction of citizens, on the other. If the scope of state support is constantly diminishing, then civil society itself must become an apologist for banking secrecy, otherwise, it will lose one of the pillars of autonomous law.

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