Commentary

September 2023

United States and Belgium: Indiscriminate obligation to report US taxpayers under FATCA challenged under EU law

In brief

On 24 May 2023, the Belgian Data Protection Authority (DPA), the authority responsible for enforcing the EU's General Data Protection Regulation (GDPR) in Belgium, issued a major decision ("**Decision**") concerning information exchanges pursuant to the US Foreign Account Tax Compliance Act (FATCA). The Decision declares the information reporting required of the Belgian tax authority and Belgian financial institutions under FATCA to be unlawful because it violates the privacy rights and protections afforded to Belgian residents under the GDPR, as well as the rights to a private life and protections of personal information guaranteed by the Charter of Fundamental Rights of the European Union.

This article appears in the third edition of the Private Wealth Newsletter 2023.

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In more detail

The Belgian government timely appealed the Decision to Belgium's Market Court, which has jurisdiction over disputes concerning the GDPR. Pending resolution of the appeal on its merits, the Market Court suspended the Decision with immediate effect so that the Belgian tax authority and Belgian financial institutions may continue to comply with FATCA, given the importance of Belgium honoring its pre-existing international commitments and reciprocal obligations.

It is anticipated that the Market Court will submit a request for a preliminary ruling to the Court of Justice of the European Union (CJEU), the EU's highest court. A CJEU decision would be binding (i.e., precedential) on the authorities of all EU member states and would, as a rule, be followed by the authorities of the European Economic Area (EEA) member states.

The Decision calls into question to what extent compliance with FATCA, as currently implemented in local laws, and similar automatic exchange of information laws will be required in the EU and EEA and how compliance may be implemented in the future. In what follows, we consider background to the Decision and FATCA, take a closer look at the analysis made in the Decision, and consider possible future implications for the compliance and enforcement framework of the Agreement between the Government of the Kingdom of Belgium and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA ("**Belgian IGA**").

Background on the Decision

In response to a complaint by a Belgian resident with dual (Belgian-US) citizenship and the Belgian Association for Accidental Americans, the Belgian DPA ruled that the GDPR prohibits the Belgian tax authority from transferring personal information to the US Internal Revenue Service (IRS) as required by FATCA. This is because the conditions set out in the GDPR for lawful transmission of data have not been met.

The complaint was submitted in 2020 after the Belgian tax authority transferred to the IRS personal information concerning the Belgian resident pursuant to FATCA, the Belgian IGA and Belgium's domestic law implementing the Belgian IGA requirements. The information concerned Belgian bank accounts held by the Belgian resident.

Since 2014, FATCA requires certain foreign financial institutions (FFIs), such as Belgian banks, to report to the IRS certain data of US citizens. These US citizens include not only persons physically resident in the US, but also nonresident US citizens, including dual nationals who may have little connection to the US (e.g., "accidental" Americans).

The US concluded similar FATCA IGAs with many jurisdictions to make FATCA compliance a matter of local law in many financial institutions' jurisdiction of residence, effectively shifting the enforcement burden to these other jurisdictions and making FATCA compliance a requirement for their financial institutions. The consequences for failure to comply with FATCA include the levying by the IRS of a 30% withholding tax on certain US-source income.

In a nutshell, the Decision states that FATCA violates various articles of the GDPR because it (i) does not provide sufficiently specific objectives for transfers of data, as required by the GDPR, and (ii) requires generalized and systematic transfer of data, which is incompatible with the GDPR's principles of proportionality and minimization of data (i.e., more information is shared than necessary).

In particular, the Decision notes that the obligations introduced by the Belgian IGA appear, at this stage and in certain circumstances, to go beyond what is necessary and proportionate, as they do not restrict reporting obligations to individuals suspected of tax fraud or evasion. It further indicates that the obligations would constitute "necessary and proportionate measures" if the US provided, on a case-by-case basis, evidence that the relevant US citizens are using the EU's financial system to evade taxes in the US. In addition, the Decision concludes, as did a prior independent report commissioned by the European Parliament, that FATCA and the Belgian IGA do not contain sufficient safeguards for the protection of information transferred to the IRS. On that basis, the Decision also finds that the Belgian tax authority breached the GDPR. The Decision notes that, while there are appropriate safeguards laid down by Belgian domestic law, these safeguards are not provided for in the Belgian IGA (as required by the GDPR) and do not apply to the IRS.

In 2021, Slovakia's data protection authority also expressed concern over the information-sharing required under Slovakia's own FATCA IGA with the US implementing FATCA. It claimed the agreement "[did] not contain even the minimum safeguards to transfer personal data to third countries" as required by the GDPR. It called for an assessment of the compliance of international agreements on exchanging tax information with the GDPR. Cases are also pending and doubts have been cast (such as in France, the Netherlands and other EU member states) on the sufficiency of US data safeguards in the context of transferring FATCA information, indicating that other EU member states are awakening to the GDPR considerations in this context. However, Belgium appears to be the first EU member state to declare such systematic and general information-gathering and transmission to the IRS unlawful.

FATCA requirements

1 July 2023 marked the nine-year anniversary of FATCA's entry into force.

FATCA was enacted by the US Congress in 2010 as part of the Hiring Incentives to Restore Employment Act (the HIRE Act) with the primary goal of preventing tax evasion by US persons who hold accounts in FFIs and fail to pay US income tax on income earned in those accounts.

The principal purpose of FATCA is to provide the IRS with information on US persons (including US citizens, resident aliens and entities resident in the US) holding financial accounts outside the US. Such information is to be used for the prevention of tax evasion in connection with unreported income or assets involving foreign financial accounts. To accomplish this purpose, FATCA requires FFIs to actively review customer accounts to identify those held by US persons and report the accounts either (a) directly to the IRS or (b) in the case of most jurisdictions with a FATCA IGA in effect, to the tax authorities in the FFI's jurisdiction of residence, which then exchanges such information with the IRS. FATCA also requires certain nonfinancial foreign entities (NFFEs) to disclose US persons who own or control such entities to FFIs for reporting purposes. There is hence a transfer of data to be made as soon as it is established that the financial accounts or NFFEs are held/owned by a US person.

An FFI that fails to perform the required due diligence and reporting of US account holders, or an NFFE that fails to provide adequate information to an FFI, faces a 30% withholding tax on payments of specified US-source income.

To facilitate the implementation of FATCA and enlist the cooperation of tax authorities in other countries around the globe, the US has entered into bilateral FATCA IGAs with over 100 other governments, including EU/EEA states to which the GDPR applies.

Under Model 1 IGAs, which represent approximately 90% of FATCA IGAs signed or currently deemed to be in effect, FFIs are required to report certain reportable US accounts to the relevant jurisdiction's tax authority, which will in turn exchange the required information with the IRS. The requirement to report is implemented according to local regulations, and the account holders' consent is generally not required.

As Belgium has a Model 1 IGA in effect, financial institutions in Belgium are required to report FATCA information to the Belgian tax authority, which exchanges such information automatically with the IRS.

The personal data to be transmitted to the IRS automatically includes the account holder's name, address, US taxpayer identification number and account number, as well as the identification of the reporting financial institution, account balance and payment amounts attributable to the account for the relevant year.

There are, however, no provisions on the protection of personal data in the Belgian IGA (as in other such FATCA IGAs), other than by reference to the protections afforded by the Convention on Mutual Administrative Assistance in Tax Matters, signed in Strasbourg on 25 January 1988, a multilateral agreement authorizing exchanges of information for tax purposes by its signatories, including the US and Belgium.

Thus, from the beginning, FATCA raised significant privacy and security concerns for reportable US account holders holding financial accounts in other jurisdictions and other reportable US persons owning or controlling certain entity account holders. When reporting, FFIs are required to disclose sensitive financial information to the US or, perhaps even more importantly, to local competent authorities where data protection and confidentiality standards may vary considerably, in some cases being stricter and in others more relaxed.

A closer look at the Decision: incompatibility of the FATCA requirements with the GDPR

25 May 2023 marked the five-year anniversary of the GDPR's entry into force.

The GDPR replaced Data Protection Directive 95/46/EC. Because it strengthens and harmonizes personal data protection in the EU, the GDPR is considered a global standard for the protection of personal information. Unlike the directive, which only took effect once EU/EEA states transposed it into national law, the GDPR became directly applicable to all EU/EEA states after its entry into force.

The GDPR is designed to strengthen individuals' ability to exercise their data protection rights, in particular to protect themselves against unlawful use or disclosure of their personal information.

As noted in the Decision, from the outset, European legislators expected data processing going forward to comply with all of the GDPR's provisions. The Decision shows how the pre-existing duties imposed by FATCA are incompatible with various requirements of the GDPR.

Lack of minimum guarantees and safeguards

Absent an applicable decision by the European Commission covering the transfer of data to the IRS, GDPR Article 46 allows the Belgian tax authority to transfer data to the IRS on the condition that the IRS provide certain safeguards and the person to whom the data relates has enforceable rights and effective remedies, either through "a legally binding and enforceable instrument between public authorities or bodies" or by "provisions to be incorporated into administrative arrangements between public authorities or bodies which provide for enforceable and effective rights for data subjects."

- Here, the Belgian DPA concluded that this condition was not met because, based on a plain reading of the GDPR, these guarantees and safeguards must be expressly included in the agreement giving rise to the authority to transfer data so that they will be fully enforceable against the IRS. As the safeguards and guarantees could only be found in reference to other agreements or laws, and not in the Belgian IGA itself, the Belgian DPA deemed this condition to be unsatisfied. It also concluded that Article 49 (which provides certain exceptions to the aforementioned requirements, e.g., transfers in the public interest) is inapplicable in the context of automated and annual (repetitive) information exchanges, such as those required by the Belgian IGA.

Noncompliance with the general principles governing transmission of personal data

For transferring personal data to the IRS under FATCA to be lawful, it must comply with the general principles of GDPR Article 5.

The **principle of finality** requires that data be collected for specified, explicit and legitimate purposes, and not further processed in a way incompatible with these purposes. This requirement exists so that the transmitter may determine that the data processed is actually necessary to achieve the purpose.

- The Belgian DPA concluded that the purposes expressed in the Belgian IGA (i.e., improving international tax rules and combatting tax evasion committed by US citizens) are not sufficiently defined, in that they do not make it possible to assess the extent to which the data processed is necessary to achieve the stated purposes (and thereby leave too much latitude to the Belgian tax authority).

The **principle of proportionality** and **data minimization** requires that data processing be strictly necessary to achieve the purpose and that it cover the minimum amount of data required to achieve the desired objective.

- In this regard, the Belgian DPA opined by analogy to recent decisions of the CJEU that an individual's nationality without any other indication of tax evasion or avoidance is an insufficient criterion in view of the purpose of identifying tax evasion and is disproportionate. The DPA noted further with regard to that purpose that many such individuals would not be subject to taxation in the US under the exemptions authorized by US law.

In general, the **principle of limited retention** requires that data be retained for no longer than is necessary.

- The Belgian DPA noted that FATCA contains no commitment by the IRS as to the limited retention of data transferred to it by the Belgian tax authority. While Belgian domestic law provides for a retention period that is binding on the Belgian tax authority, it does not bind the IRS to a limited data retention period under the Belgian IGA.

Violation of the data subjects' rights

The GDPR affords certain rights to individuals when they are the subject of a data transfer.

Article 12 provides that an individual has the **right to be informed** by the data transmitter of the transfer of their data to the IRS. Article 14 provides **additional information** that needs to be communicated to the data subject when the personal data is not obtained directly from them.

- In this regard, the Belgian DPA concluded that, having received information from the bank, the Belgian tax authority was obligated to actively communicate to the Belgian resident concerned information about the data transmitted to the IRS in a clear, simple and easily accessible manner.

  The Belgian DPA noted that some, but not all, of the information regarding the data to be transferred to the IRS had been communicated by the bank. The Belgian tax authority's website, which informs on "more theoretical explanations, news, links to relevant documents and an FAQ," is inadequate. The DPA found that the information is inaccessible, as it is both too general and technical, often in English, and in large part aimed at financial institutions rather than individuals.

Because the information provided on its website was neither easily accessible nor comprehensible, and was not actively communicated to the Belgian resident, the Belgian DPA concluded that the Belgian tax authority did not comply with its obligations under Articles 12 and 14.

Absence of data protection impact assessment

GDPR Article 35 provides that when data transmission is likely to put the rights and freedoms of natural persons at high risk, the data controller is required, prior to transmission, to conduct a data protection impact assessment (DPIA). This is an analysis of the impact of the processing operations envisaged on the protection of personal data.

- Here, the Belgian tax authority argued for an exception to the requirement to conduct a DPIA on the basis that the transmission was previously authorized by a competent authority in accordance with prior law and the implementation of the transmission process had not changed. However, the Belgian DPA concluded that the prior authorization was insufficient because its analysis did not focus on the existence of appropriate safeguards within the meaning of the GDPR and because the implementation of the transfer to the IRS had in fact changed since the prior authorization. The Belgian DPA hence concluded that a new DPIA was required as there are minimum indications of risk to the individual, and the transfer involves the US, whose level of data protection is not considered adequate and has been the subject of ongoing controversy for many years.

No escape on the basis that the Belgian IGA is a previously concluded agreement

As a final provision, Article 96 of the GDPR governs the relationship of the GDPR (which came into force in 2018) with previously concluded agreements, such as the Belgian IGA (which came into force in 2014).

In particular, this article provides an exception according to which international agreements existing before the implementation of the GDPR may nevertheless remain in force as is, provided that they complied with the EU law applicable at the time they were concluded.

- The Belgian DPA interprets Article 96 as essentially providing for a transitional regime subject to conditions, the objective of which is "to ensure comprehensive and consistent protection of personal data in the Union" while protecting the rights of third parties (e.g., the IRS) acquired under international agreements concluded prior to the enactment of the GDPR (e.g., the Belgian IGA). Specifically, the DPA concludes that data transmitters that transmit data pursuant to international agreements concluded before 24 May 2016 are not totally exempt from the GDPR because EU/EEA states have a duty to (re)negotiate, in fulfillment of their duty of loyalty to the laws of the EU, a FATCA IGA in line with the GDPR. The more time passes, the less acceptable the lack of a renegotiated FATCA IGA becomes.

  The Decision further notes that, as early as 2021, the data protection authorities of EU/EEA states, including the Belgian DPA, invited EU/EEA states to review their international agreements in the light of the GDPR, in particular agreements related to automatic exchanges of information for tax purposes.

  The Decision concludes that the Belgian IGA is now invalid (considering the violations of the GDPR) and cannot benefit from the protection of this rule.

Note, however, that the Belgian Market Court acknowledged the ambiguity in temporal scope of this exception and suspended the Decision to prohibit transfers of data pending an appellate decision on the merits.

FATCA reporting remains in force pending further developments

Basing its decision partly on the ambiguity in temporal scope of the Article 96 exemption, but also the political interests of the Belgian state, the Belgian Market Court suspended the Decision pending a decision on the merits of the appeal. The Belgian tax authority has confirmed in the meantime that it will proceed with the transfer of data under FATCA for 2023 under the usual conditions and timeline.

The Belgian Market Court could refer the case to the CJEU for a preliminary ruling (the CJEU's subsequent ruling will be binding in the EU and will have quasi-binding effect in the EEA). In this context, it is interesting to see that CJEU jurisprudence indicates a willingness to strengthen data protections, and not only in the FATCA (or GDPR) context. See, for example, our article on the CJEU's decision to invalidate a Luxembourgish law granting unlimited access to Luxembourg's register of beneficial owners to the general public.

As recently as 22 June 2023, the CJEU ruled in favor of greater GDPR protections in a case also originating in Luxembourg and involving a Finnish bank. The ruling concluded that a bank customer — who also happened to be a bank employee — had a right to discover (a) why their personal data was accessed by other employees, and (b) these employees' identities if needed to determine the lawfulness of that access, while balancing the employees' rights to privacy.

Potential consequences and the future of FATCA IGAs

While the Belgian tax authority and Belgian financial institutions are obligated to comply with the Belgian IGA pending the appeal of the Decision, the dispute raises some questions for both financial institutions conducting FATCA reporting and account holders across the EU potentially subject to reporting.

The Belgian IGA is similar to other bilateral agreements signed by the US with other EU/EEA states. Data transfers' compliance with the GDPR based on these agreements, even if bilateral (and supplemented by national legislation), must be assessed as consistently as possible in these states.

On the one hand, it seems unlikely that the Decision will put an end to the burden for non-US jurisdictions and their financial institutions to comply with the extraterritorial reporting FATCA regime. More likely, however, is that existing agreements will be adapted to comply with the terms of the GDPR, at least in the EU/EEA and perhaps with spillover effects into other jurisdictions.

The Belgian Market Court has suspended the Decision so that Belgian financial institutions are, as a rule, required to continue to comply with the Belgian IGA. In the absence of information-sharing under a FATCA IGA with Belgium, Belgian financial institutions could be subject to the punitive 30% withholding tax on all "withholdable payments" derived from US sources.

It remains to be seen whether the US Treasury Department would take the radical step of threatening to list a jurisdiction's financial institutions as nonparticipating for FATCA purposes based on a data privacy challenge to the exchange of FATCA information, especially in the present situation where the Decision has been suspended. It is after all in the economic interests of both the US and its EU trading and financial partners to find a sustainable solution to this issue in the near future, whether through amended FATCA IGAs or protocols to such FATCA IGAs (i.e., on a state-by-state basis), a memorandum of understanding (i.e., on a one-size-fits-all-states basis), enhanced data protection standards in the US, or some combination of solutions.

With respect to data protection standards in the US, for example, recent reports of the US Treasury Inspector General for Tax Administration (TIGTA) criticized the IRS for failing to adequately protect sensitive taxpayer information. In the context of transferring such taxpayer information among various IRS divisions, the IRS in some cases ships requested information using a private delivery carrier. TIGTA has raised concerns that the IRS has not taken appropriate actions to account for and control sensitive taxpayer information. TIGTA also reported recently that the IRS inexplicably was unable to account for thousands of microfilm cartridges, each holding up to 2,000 images of individual and business tax records.

The IRS expects to address such information security weaknesses by modernizing its operations using funding from the Inflation Reduction Act of 2021, in particular by introducing more digital systems and processes to transmit taxpayer information, increasing IT personnel, and improving IT leadership. While not directly linked to FATCA, such issues plaguing the IRS' handling of taxpayer data could be reflected in a review of the IRS' data protection standards with respect to GDPR compliance of FATCA IGAs.

Ultimately, the solution(s) will depend, in part, on whether the Decision is referred to the CJEU and what the CJEU's assessment will be, noting that the CJEU is quite protective of personal data and its decision would be binding on all EU/EEA states.

Beyond FATCA, a CJEU ruling in this case could also impact other automatic exchange of information laws imposed in EU/EEA states, including the Common Reporting Standard.

To be continued…

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