FATCA Update and its Global Reach

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Background

- Estimates of @1 million offshore accounts held by US taxpayers valued at between $10B and $1.5 trillion

- 2009-10: Charges brought against a number of foreign banks for assisting US taxpayers evade US tax liability

- **FATCA enacted March 18, 2010, as part of the Hiring Incentives to Restore Employment Act ("Hire Act")**
  - Goal: Prevent tax evasion by US persons
  - Accomplishes goal by requiring foreign financial institutions (FFIs) and others to document, withhold and report on U.S. persons that have offshore accounts or investments
  - Failure to do so subjects the FFI, other affected payors and payees to a 30% withholding on certain U.S. sourced payments.
  - Final regulations issued on January 17, 2013

• Who has to comply?

- Foreign Financial Institutions (FFIs)-banks, custodians, insurance companies, investment entities
  - Entities that accept deposits; hold financial assets for others as ordinary course of business; engage primarily in the business of investing, reinvesting, or trading in securities, etc.
- US withholding agents (USWAs)

- **What do FFIs have to do to comply with FATCA?**
  - Enter into an agreement with the IRS, requiring
    - The FFI to obtain information from account holders to determine their US status or non-US status --individuals and non-financial foreign entities (NFFEs)-- or whether they are participating FFIs or non-participating FFIs
      - "Account holder" includes depositors, lenders, bondholders, investors, derivatives counterparties.
      - Payments made to classes of persons posing low risk of tax evasions excluded, e.g., foreign governments, foreign central banks, international organizations, certain retirement funds and deemed compliant FFIs
      - NFFEs can avoid 30% withholding tax if they provide, among other things, name, address and TIN for each substantial US owner.
        - Family trusts are considered NFFEs, unless they are professionally managed, which would make them either a FFI or an owner-documented FFI
        - Excepted NFFEs, include Active NFFEs where less than half their income is passive, and corporations whose stock is traded on an established securities market; nonfinancial start-ups; nonfinancial entities emerging from reorganization or bankruptcy.

- **What else do FFIs have to do to comply with FATCA?**
  - Comply with verification, due diligence, and reporting requirements for US accountholders
  - Withhold US tax on payments to recalcitrant account holders and eventually close account
  - Withhold US tax on payments to non-participating FFIs.
  - Build compliance program

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- **For FFIs, are there any reasonable alternatives to complying with FATCA?**
  - Cease holding US assets
  - Accept 30% withholding on US sourced income

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Verification and Due Diligence for Existing Accounts

- Due Diligence requirements on existing accounts for participating FFIs (PFFIs) and USWAs
  - PFFIs: Tiering approach for pre-existing individual and entity accounts
    - Individual Accounts
      - With aggregate balances in excess of $1MM, enhanced review for US indicia and must be completed by January 1, 2015
      - With aggregate balance in excess of $50K, electronic search for US indicia required and must be completed by January 1, 2016
      - Certain de minimis accounts, no review required (treated as non-US account) but ongoing monitoring required

- **PFFIs due diligence requirements (continued)**
  - Entity Accounts
    - With aggregate balance in excess of $250K held by Prima Facie FFIs, review completed by July 1, 2014
    - With aggregate balance in excess of $250K by other than Prima Facie FFIs, review completed by January 1, 2016
    - With aggregate balance of $250K or less, no review required (treated as non-US account) but ongoing monitoring required

- **USWA due diligence requirements**
  - Accounts that are Prima Facie FFIs: review completed by July 1, 2014
  - Accounts other than Prima Facie FFIs that are NFFEs: review completed by January 1, 2015
  - Accounts other than Prima Facie FFIs that are FFIs: review completed by January 1, 2016

Verification and Due Diligence for New Accounts

- Must be in place by January 1, 2014
- Accounts over $50K in aggregate
- Performed within 90 days of account opening or date of first withholdable payment

Documentation Requirements

- Vary depending on if the account is: onshore vs. offshore; pre-existing or new; individual or the type of entity.
  - Withholding certificates (Forms W-8 and W-9)
  - Documentary evidence that satisfies home country requirements, e.g., file notations rather than copies of driver's licenses
  - Generally, documentary evidence satisfying BSA/AML KYC requirements
  - Validity, until expiration and possibly indefinitely unless change in circumstances
  - New accounts of a customer that has a preexisting obligation can be treated as a pre-existing account under certain circumstances

Withholding

- USWAs and PFFIs to begin withholding on U.S. source FDAP income starting next year
  - Tiered approach:
  - January 1, 2014 for New accounts, non-participating FFIs, and certain recalcitrant accounts;
  - July 1, 2014 for pre-existing accounts for Prima Facie FFIs;
  - January 1, 2015 for pre-existing accounts for non-compliant NFFEs;
  - January 1, 2016 for pre-existing accounts for non-participating FFIs; and, January 1, 2017 expands to include income from gross proceeds from property producing U.S. source interest or dividends.

What are withholdable payments?

- FDAP (fixed, determinable, annual, periodical) income: Dividends, interest, lending transactions, forwards, futures, options, other derivatives contracts, fee payments, e.g., investment advisory, brokerage, custodial
  - Obligations outstanding on 12/31/13 grandfathered; does not include equity or deposit accounts
- Where source or character of payment unknown: presumed to be a withholdable payment
- After 12/31/16 (at the earliest), will also include gross proceeds and returns of principal and, possibly, foreign passthru payments
  - Foreign passthru payments include foreign-source payments that are "attributable to" US sourced income. Query: Does this include "passthru payment percentage?"

Reporting

- FFIs
  - Form 8966 (FATCA Report) to come
    - For accounts for specified US persons: Name, address, TIN, account number, account balance, payments of income and gross proceeds
    - For accounts for US owned foreign entities: Name, address, TIN, account number, account balance, payments of income and gross proceeds, name, address and TIN for each substantial US owner of entity
    - Reports due:
      - 2015 for 2013 and 2014 information
      - Income payment information not due until 2015 calendar year report
        - Gross proceeds information not due until 2016 calendar year report
      - Aggregate reporting required for recalcitrant accounts

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Reporting (continued)

- USWAs
  - Also Form 8966
    - For accounts for US owned foreign entities: same as above
    - No reporting for accounts directly owned by specified US persons, no aggregate reporting on recalcitrant accounts
    - Reporting begins in 2015 for 2014 calendar year; no phased reporting similar to above

What about privacy restrictions and other foreign law impediments to disclosure?

- Obtain waiver from US account holders
- Not realistic; intergovernmental agreements or IGAs developed in response to concerns about violating local law.
- Two types of Model IGAs:

- **Model I**
  - Provides that national governments will enact legislation requiring local financial institutions to disclose information regarding US accountholders to the home country authorities who will then pass on the requisite information to the IRS.
  - In return, these institutions will be deemed to be compliant with FATCA's withholding and reporting requirements. Eliminates need to sign agreement with IRS.
  - To date, 4 countries have signed Model I agreements with the IRS.
  - Note: These agreements are reciprocal and US financial institutions could be required to provide information about foreign national accounts held in the US.

- **Model II**

  - Provides that FFIs will enter into agreements with the IRS and make the disclosures, as required under the IGA, concerning US accountholders to the IRS.
  - Specialized partner country agreements may be required with respect to "non-consenting accounts."
  - To date, only Switzerland has signed a Model II agreements.

- **Outstanding IGA Issues:**
  - Model I IGAs need home country implementing legislation. Timing?
  - Impact on FFIs in non-IGA jurisdictions? Breach of local law? Accept that non-IGA operations will be non-compliant and thus subject to withholding? Dispose of operations in non-IGA jurisdiction?
  - Impact on FFIs operating in more than one jurisdiction under different IGAs or no IGA?

Next steps

- IRS Registration for participating FFIs and deemed compliant FFIs begins no later than July 15, 2013.
  - October 25, 2013 last day to register to be on December 2, 2013 list of participating and deemed compliant FFIs; list to be updated monthly
  - Registration through IRS Portal
    - Global Intermediary Identification Number: necessary for both reporting to IRS and to identify status to withholding agent
    - Revenue Procedure to come on online registration process

FFI Compliance program requirements

- Responsible officer designation
- Establish policies and procedures to satisfy FFI agreement
- Provide periodic certifications
  - Compliance and effective internal controls: every 3 years
    - Includes certification there were no material failures or if there were, appropriate remedial actions taken
      - Material failures, include civil penalties imposed in connection with failure to properly identify account holders under AML procedures
  - Due diligence on pre-existing accounts: one time
  - Non-assistance to account holders to avoid FATCA reporting: one time

- # Outstanding issues:

  - Timing: Compliance deadlines
  - Sunset date of 12/31/15 for "limited" status of branches and affiliates;
  - Interaction with FFIs in IGA countries
  - Treatment of branches and agencies of foreign banks –clarity needed;
  - Non-Commercial Investment Entities –NFFE vs. FFI or Owner Documented FFI
  - Alignment with AML/KYC
  - Securitization vehicles fix to treat as certified deemed compliant FFI through 2016 –too narrow;
  - Withholding for DVP/COD Transactions –TBD; and,
  - Foreign passthru payments, e.g. payment from a non-participating FFI to a participating FFI --TBD

Questions?

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