Why You Still Need to Care about FATCA

March 13, 2012

Mary Burke Baker
Roger S. Wise
FATCA: Foreign Account Tax Compliance Act

- History
- Nuts and Bolts
- Highlights of Proposed Regulations
- Intergovernmental Agreement
- Next Steps
- Q&A
FATCA: Where It Began

Public Law 111–147
111th Congress

An Act
Making appropriations for the Departments of Commerce and Justice, and Science, and Related Agencies for the fiscal year ending September 30, 2010, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Mar. 18, 2010
[H.R. 2847]
Hiring Incentives

* * *

TITLE V—OFFSET PROVISIONS
Subtitle A—Foreign Account Tax Compliance

PART I—INCREASED DISCLOSURE OF BENEFICIAL OWNERS

SEC. 501. REPORTING ON CERTAIN FOREIGN ACCOUNTS.

(a) IN GENERAL.—The Internal Revenue Code of 1986 is amended by inserting after chapter 3 the following new chapter:

“CHAPTER 4—TAXES TO ENFORCE REPORTING ON CERTAIN FOREIGN ACCOUNTS

[Secs. 1471, Withholdable payments to foreign financial institutions.
Sec. 1472, Withholdable payments to other foreign entities.]"
History of FATCA

- FATCA was the result of a “perfect storm” of world events, technological changes, the economic crisis and political pressure to curb offshore tax abuse

- Existing law and administrative authority were insufficient to detect and deter offshore tax evasion

- FATCA is a sea change approach to international tax compliance intended to thwart offshore tax evasion by giving the IRS tools to identify US owners of foreign accounts and entities

- An innovative approach attempting to overcome sovereign barriers to encourage voluntary compliance
FATCA: Nuts and Bolts

If you have US source payments, you need to care about FATCA
FATCA: Nuts and Bolts

Carrot: Foreign financial institutions ("FFIs") agree to tell the IRS about their US accounts; non-financial foreign entities ("NFFEs") agree to tell withholding agents about their substantial United States owners.

Stick: 30% withholding tax on all "withholdable payments"
**Bank:** any entity that accepts deposits in the ordinary course of a banking or similar business

**Custodian / Broker-dealer:** any entity that holds, as a substantial portion of its business, financial assets for the account of others
Investment Vehicle: any entity that is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, notional principal contracts, insurance or annuity contracts, or any interest (including a futures or forward contract or option) in any of these.
Specified US Person

US-Owned Foreign Entity

Non-US Account Holder

Financial Account includes:
- Annuities
- Cash value insurance

FFI: Insurance Company

- Gross proceeds from sales
- Dividends
- Interest

US Stock

US Bond

Insurance Company: any entity that is an insurance company (or the holding company of an insurance company) that issues or is obligated to make payments with respect to any financial account.
Proposed Regulations
How Many Pages Does It Take to "FATCA"?

The Act: 10 pages

The Proposed Regulations: 388 pages
Highlights of Proposed Regulations

- Deemed-compliant entities
- Due diligence procedures
- Verification procedures
- Phase-in of withholding, passthru payments
- Phase-in of information to be reported
- Legal barriers to compliance
- Grandfathered obligations
Highlights of Proposed Regulations

“All generalizations are false, including this one.”

– Mark Twain
Highlights of Proposed Regulations: Deemed-Compliant Entities

• Deemed-compliant entities divided into 2 broad categories:
  • Certified: involves certification to withholding agent, no direct IRS oversight or registration
  • Registered: must register with IRS and undertake due diligence

• New types of registered deemed-compliant entities
  • Qualified collective investment vehicle
  • Restricted fund
Highlights of Proposed Regulations: Due Diligence Procedures

• Individual accounts
  • $\leq$ $50,000$ exempt ($\geq$ $250,000$ for annuities/insurance)
  • New accounts: Generally rely on AML/KYC
  • Preexisting accounts: Search for US indicia
    • $50,000 - $1$ million: electronic search
    • Over $1$ million: electronic and paper record search
  • Generally must complete by June 30, 2015
• Aggregation rules apply, including when relationship manager has knowledge
Highlights of Proposed Regulations: Due Diligence Procedures (continued)

• Entity accounts
  • ≤ $250,000 exempt
  • In general, must determine status of account holder by June 30, 2015
    • June 30, 2014 for “prima facie FFIs”
    • Exceptions provide more time in specific situations
  • Special focus on “passive NFFEs”
    • For preexisting accounts $250,000 to $1 million, rely on AML/KYC
    • For accounts > $1 million, need certification
Highlights of Proposed Regulations: Verification

- FFI agreement will specify verification requirements
- FFI may rely on third parties to perform due diligence, but FFI ultimately responsible
- Third party audits not required
- “Responsible officer” must certify compliance to IRS
- Non-compliance may trigger additional IRS scrutiny
  - But no strict liability: high threshold before kicked out of program
Highlights of Proposed Regulations: Phase-in of Withholding, Passthru Payments

• Starting in 2014: Withholding on payments of US-source passive income
  • “Fixed and determinable annual or periodical” or “FDAP” income

• Starting in 2015: Withholding on gross proceeds

• No withholding on “foreign passthru payments” until January 1, 2017 at earliest
  • But reporting required on “foreign reportable amounts” made in 2015 and 2016
Highlights of Proposed Regulations: Phase-in of Withholding, Passthru Payments

- FFI must withhold 30% from any “passthru payment” to recalcitrant account holder or non-participating FFI
  - Withholdable payment
  - “Foreign passthru payment”: not yet defined

- FFIs can also elect to be withheld on rather than withhold on passthru payments

- Delay in withholding on passthru payments
  - Process proposed in Notice 2011-34 heavily criticized
Highlights of Proposed Regulations: Phase-in of Information to be Reported

- September 30, 2014: Reports due for 2013
- March 31, 2015: Reports due for 2015
  - For 2013 and 2014, report only name, address, TIN, account number, and account balance
- March 31, 2016: Reports due for 2015
  - In addition to above, also report income
- March 31, 2017: Reports due for 2016
  - In addition to above, also report gross proceeds
Highlights of Proposed Regulations: Legal Barriers to Compliance

- In general, FFI cannot comply with FATCA unless all members of its expanded affiliated group also comply.
  - However, this rule prevents any FFI from coming into the system if even one of its affiliates cannot because of local law restrictions.

- Regulations provide 2 years for all members to come into compliance.
  - In meantime, restrictions apply to these affiliates, referred to as “limited FFIs” and “limited branches”.
Highlights of Proposed Regulations: Grandfathered Obligations

• No withholding on payments on, or gross proceeds from disposition of, “grandfathered obligations”
• Grandfathered obligation: any obligation outstanding on January 1, 2013
  • Had been March 18, 2012
• More detail on definition of “obligation”
  • Debt instrument under tax principles
  • Revolving credit facility or line of credit
  • Certain life insurance and annuity contracts
  • Confirmation under ISDA master agreement
  • But not equity or if lacks stated expiration or term
Intergovernmental Approach

• Framework announced same day as proposed regulations

• US, UK, France, Germany, Italy and Spain agreed to “explore” alternative way to comply with FATCA

• FFI reports FATCA information to home country, not IRS

• Home country shares information with IRS; IRS agrees to reciprocate with information on foreign accounts in US
Intergovernmental Approach (continued)

• Way to overcome legal barriers to FATCA compliance

• Potentially less burden on FFIs and would avoid direct FFI contact with IRS

• Consistent with Treasury and OECD strategy to increase transparency and information sharing

• Ambitious and unrealistic timeframe to enact enabling legislation and implement

• Considerable uncertainty for FFIs in these countries
What Next?
Next Steps

Comments on proposed regulations due by April 30, 2012
⇒ Public hearing on May 15, 2012

<table>
<thead>
<tr>
<th>Possible Issues for Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>• FFI Agreement Review</td>
</tr>
<tr>
<td>• Due Diligence Procedures</td>
</tr>
<tr>
<td>• Coordinating FATCA with QI Regime</td>
</tr>
<tr>
<td>• Definition of “Other Financial Payment”</td>
</tr>
<tr>
<td>• Additional Categories of Deemed-Compliant FFIs</td>
</tr>
<tr>
<td>• Coordination of Withholding under Chapters 3 and 4</td>
</tr>
<tr>
<td>• Anti-Abuse Procedures</td>
</tr>
<tr>
<td>• Allocating Gross Proceeds by a Flow-Through Entity</td>
</tr>
<tr>
<td>• Blockers</td>
</tr>
<tr>
<td>• Refund Procedures</td>
</tr>
<tr>
<td>• File Waivers</td>
</tr>
</tbody>
</table>
Next Steps (continued)

Comments on proposed regulations due by April 30, 2012
⇒ Public hearing on May 15, 2012

<table>
<thead>
<tr>
<th>Possible Issues for Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Registration Review Procedures</td>
</tr>
<tr>
<td>• Centralized Compliance Option for FFI Groups</td>
</tr>
<tr>
<td>• Revisions to QI, WP, WT Agreements</td>
</tr>
<tr>
<td>• Interaction of FATCA and treaties</td>
</tr>
<tr>
<td>• Revised Forms</td>
</tr>
<tr>
<td>• Treatment of Equity Interest in Securitization Vehicles – Debt or Equity?</td>
</tr>
<tr>
<td>• IRS Administration and Enforcement</td>
</tr>
</tbody>
</table>
Circular 230 Notice

To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed within.