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# The Foreign Account and Tax Compliance Act (FATCA)

## Highlights of the Proposed Regulations

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# Overview of FATCA Guidance

- Notice 2010-60 issued on August 27, 2010
  - Provides preliminary guidance regarding classifying FFIs and NFFEs, due diligence procedures for identifying US Accounts and, reporting procedures for US Accounts
  - Requested additional comments on a large number of topics by November 1, 2010
- Notice 2011-34 issued on April 8, 2011
  - Revises guidance relating to identifying preexisting US Accounts
  - Guidance relating to passthru payments
  - Guidance relating to obtaining deemed compliant FFI status
- Notice 2011-53 issued on July 14, 2011 (revised July 25, 2011)
  - Provides for phase in of FATCA over several years
- Proposed Regulations issued on February 8, 2012 (published on February 15, 2012)
  - Provides process for US account identification, information reporting, and withholding requirements for FFIs, other foreign entities, and US withholding agents
  - Supersedes guidance provided in all Notices
  - Requests comments on a variety of topics; comments due April 30

# FATCA In a Nutshell

- Applies to:
  - Non-US financial intermediaries that have US clients, directly or indirectly, and
    - For this purpose a US client is determined using the US tax law definition of US person: a resident of the United States (green card holder or person that satisfies the substantial presence test ) or a US citizen (including a dual citizen)
  - Virtually every non-US financial intermediary that holds, trades or invests in US investment property for itself or on behalf of an account holder (whether or not the client is a US person)
    - Includes: banks, trust companies, custodians, hedge funds & other collective investment vehicles, securitization and other special purpose vehicles, and insurance companies that issue policies that have “cash value”
    - Excludes: Non-financial holding companies, start-up companies, entities in the process of liquidation or reorganization, hedging or financing centers of non-financial groups with respect to transactions with non-FFI affiliates, and certain charitable organizations
  - US financial institutions that make payments to non-US entities

# FATCA In a Nutshell (continued)

- FFIs have two (possibly three) choices:
  - Option 1: Enter into agreement with IRS to disclose everything about US persons who directly or indirectly have accounts or ownership
  - Option 2: 30% withholding tax imposed on all US source income (e.g., interest or dividends) and on gross proceeds from sale of such property. Tax would be imposed on assets beneficially owned by the entity and account holders
  - Option 3: Obtain “deemed compliant” status by either showing the IRS that you have no US person clients/owners or the IRS determines that your entity provides a low risk of tax evasion
    - Registered Deemed-Compliant FFIs
    - Certified Deemed-Compliant FFIs
    - Owner-Documented FFIs

# 10 Key Points in the Proposed FATCA Regulations

Additional Categories of Deemed-Compliant FFIs and Exempt Beneficial Owners

Clarification of the Definition of Financial Account and Withholdable Payment

Different Regime for US Withholding Agents and FFIs

Increased Transitional Relief for Reporting and Foreign Passthru Payments

Transitional Rules for Affiliates with Legal Prohibitions on Compliance

Modified Due Diligence Procedures (and Information Reporting)

Compliance Verification Procedures

Expanded Scope of Grandfathered Obligations

Potential Alternative Regime: “Intergovernmental Agreement”

# Registered Deemed-Compliant FFIs

- Local FFIs
  - Very generally, FFI and all members of its affiliated group must be organized in the same country and may not have a fixed place of business or solicit accounts outside its country of organization
  - Only for banks, securities brokers, financial planners or investment advisors
- Nonreporting Members of Participating FFI Groups (ring fence exception)
  - Must identify any preexisting US accounts or accounts held by nonparticipating FFIs (using due diligence procedures) and must either enter into an FFI agreement, transfer the account, or close the account
  - Must ensure any subsequently opened US accounts or accounts held by nonparticipating FFIs are either transferred to a participating FFI or US financial institution or such FFI becomes a participating FFI
  - Must identify accounts that later become U.S. accounts or accounts held by nonparticipating FFIs due to a change in circumstances and must transfer such account or become a participating FFI
  - Potentially an option for groups that exit US clients or place them in an appropriate entity

## Registered Deemed-Compliant FFIs (cont'd)

- Qualified Collective Investment Vehicles
  - Only for investment funds regulated as such by country of organization
  - Sales only to PFFIs, RDCFFIs, Exempt Beneficial Owners and US persons that are not specified US owners
  - Sales to individual investors or other entities are not permitted
- Restricted Funds Regulated as Investment Funds
  - Only for investment funds regulated as such by country of organization
  - Restrictions on sales to US persons and NPFFIs
  - Limitations on who may act as a distributor
  - Restricted fund will redeem shares if distributor is not longer qualified to distribute fund interests or if shares are known to be owned by a US person or NPFFI
- FFIs deemed to comply pursuant to an intergovernmental agreement
  - Terms of proposed intergovernmental agreements are not yet known

## Certified Deemed-Compliant FFIs

- Only treated as deemed compliant with respect to the withholding agent to whom the CDCFFI certifies its status by providing a withholding agent with required documentation
  - Nonregistering Local Banks
  - Retirement Funds (different requirements than retirement funds that are considered exempt beneficial owners)
  - Non-Profit Organizations established exclusively for charitable purposes
  - FFIs with only Low-Value Accounts (*i.e.*, in FFI or affiliated group in aggregate, no accounts in excess of \$50,000 and no more than \$50,000,000 in assets on balance sheets)
- Owner documented FFIs are similar to CDCFFIs but require the owner(s) to provide additional information to the withholding agent



# Exempt Beneficial Owners

- Foreign Governments
- International Organizations
- Foreign Central Bank
- Foreign Retirement Funds (two methods of qualification)
  1. Fund is a treaty resident generally exempt from income tax in the fund's country of residence and satisfies any applicable LOB provision, and is operated principally to administer or provide pension/retirement benefits
  2. Fund is formed for the provision of retirement/pension benefits, receives all contributions from government, employer, or employee contributions that are limited by reference to earned income, no one beneficiary has the right to more than 5% of the fund's assets, and investment income earned is exempt from income tax in country of residence or 50% or more of contributions are from government or employer
- Entities wholly owned by exempt beneficial owners

# Refined Definition of Financial Account and Withholdable Payment

- Financial Account:

- Refined to focus on traditional bank, brokerage, money market accounts, and interests in investment vehicles
- Most debt and equity securities issued by banks and brokerage firms are excluded
- Certain savings accounts (including both retirement and pension accounts and nonretirement savings accounts) that meet certain requirements with respect to the tax treatment and the type and amount of contributions are excluded
- Explicitly includes insurance contracts that have “cash value”

- Withholdable Payment:

- Any payment of US source FDAP income (*i.e.*, interest, dividends, rents, premiums, annuities, etc.) and any gross proceeds from the sale or other disposition (occurring after December 31, 2014) of any property of a type which can produce interest or dividends that are US source FDAP income
- Payments not treated as “withholdable payments include: payment of interest or original issue discount on short-term obligations; effectively connected income; ordinary course of business payments (for nonfinancial services, goods, and the use of property)

# Different Due Diligence Obligations for US Withholding Agents and FFIs

- US financial institutions due diligence obligations for individual accounts
  - US Withholding Agents will generally be able to rely on previously collected certifications (W-8s and W-9s)
  - If a valid Form W-9 is associated with a payee, a withholding agent must treat such payee as a US person
  - If a valid withholding certificate identifies a payee as a foreign individual, a withholding agent must treat such payee as a foreign individual
- FFIs generally must obtain certifications or documentation from individual clients but must also verify that such documentation has no US indicia
- US financial institutions are subject to similar rules as FFIs only when making payments to entities

# Increased Transitional Relief for Reporting/Foreign Passthru Payments and Expanded Scope of Grandfathered Obligations

- Phase-In of Reporting Obligations:

- For reporting in 2014 and 2015, FFIs are only required to report the name, address, TIN, account number, and account balance with respect to U.S. accounts
- Beginning in 2016, income associated with such accounts must also be reported
- Beginning in 2017, full reporting, including information on the gross proceeds from broker transactions will be required

- Phase-In of Scope of Passthru Payments:

- Beginning on January 1, 2014, FFIs will be required to withhold on passthru payments that are withholdable payments
- Beginning on January 1, 2014, FFIs will also be required to report annually on the aggregate amount of certain payments to each nonparticipating FFI for the 2015 and 2016 calendar years
- Beginning no earlier than January 1, 2017, the scope of passthru payments will be expanded beyond withholdable payments to include foreign passthru payments

- Grandfathered Obligations:

- The date used to determine whether a debt obligation is exempt from FATCA pursuant to the “Grandfathered Obligation” rule has been extended from March 18, 2012 to January 1, 2013

# Transitional Rules for Affiliates with Legal Prohibitions on Compliance

- With respect to affiliated groups, a two-year transition rule is provided for affiliates with legal prohibitions on compliance
  - FFIs that are members of an expanded affiliated group can enter into FFI Agreements and will not be disqualified even though certain FFI affiliates or branches may not be able to fully comply with FATCA due to restrictions in that affiliate’s jurisdiction
    - Full implementation will still be required to be achieved by January 1, 2016
  - The entities unable to fully comply are considered “limited FFI affiliates” and “limited branches” and will be subject to withholding upon receipt of withholdable payments but will not be obligated to report any information to the IRS
    - Limited FFI must agree to account identification requirements and must agree to not open new US accounts or accounts for nonparticipating FFIs

# Due Diligence Procedures

- Proposed regulations eliminate subjective Private Banking Test, and replace it with objective test based simply on value of accounts
- Preexisting Individual Accounts:
  - No requirement to review or document accounts of \$50,000 or less or certain cash value insurance or annuity contracts of individual account holders of \$250,000 or less
  - Due diligence procedures now focuses primarily on a review of electronically searchable data for US indicia
  - Manual review of paper records and relationship manager inquiries generally limited to high-value accounts (*i.e.* accounts that exceed \$1,000,000)
- New Individual Accounts:
  - Due diligence procedures similar to those for preexisting accounts
  - FFI must review the information provided at the opening of the account, including any identification and any documentation collected under ALM/KYC rules for US indicia

# Due Diligence Procedures

- Preexisting Entity Accounts:

- Accounts of \$250,000 or less are excluded from due diligence requirements until account exceeds \$1,000,000
- Due diligence with respect to remaining preexisting entity accounts generally relies on an FFI's AML/KYC records and other existing account information for determining whether the entity is an FFI, is a US person, is excepted from the requirement to document substantial US owners (for example, because it is engaged in a nonfinancial trade or business), or is a passive NFFE
- Must apply certain presumptions regarding payee status and meet certain documentation requirements
- For accounts of passive NFFEs, FFIs may generally rely on information collected for AML/KYC due diligence purposes to identify substantial US owners. If, however, such account exceeds \$1,000,000, FFIs must obtain information regarding all substantial U.S. owners or a certification that the entity does not have substantial US owners

- New Entity Accounts:

- Documentation determinations are similar to those applicable to preexisting entity accounts
- Generally need to obtain withholding certificates or written statements (signed under penalties of perjury) along with other supporting documentation
- Need to look thru passive NFFEs to determine whether they have any substantial US owners

# Compliance Verification Procedures

- Compliance with FFI Agreement must be certified by responsible FFI officer
  - Third party audits will not be mandatory
  - If FFI Agreement is complied with, FFI will not be strictly liable for failure to identify a US account
    - It is not clear whether this “strict liability” standard encompasses reliance on electronic search data that is known or should be known to be faulty
- Responsible officer must confirm, with respect to preexisting high-value accounts, that the participating FFI has completed the required review (within 1 yr) and did not have any formal or informal practices in place at any time from August 6, 2011 through the certification date to assist account holders in the avoidance of FATCA
  - This rule somewhat mutes the retroactive nature of the certification requirement contained in Notice 2011-34 such that it applies 120 days after that notice was issued.
- Responsible officer must also confirm with respect to all preexisting accounts, that the participating FFI completed the account identification procedures and documentation requirements (within 2 yrs) or, that it treats account holder’s with missing documentation as recalcitrant or as a nonparticipating FFI



# Potential Alternative Regime: “Intergovernmental Agreement”

- US, France, Germany, Italy, Spain, UK issued a joint statement in support of the underlying goals of FATCA but recognized legal impediments to compliance
- US is open to an intergovernmental approach to implementing FATCA
- Possible Framework for Intergovernmental Approach involves US and Partner Country entering into an agreement
  - Partner Country would pursue legislation to implement a regime whereby FFIs would perform due diligence to identify US accounts and report to their local government. Partner Country would then transfer such reported information to the US
    - FFIs in Partner Country would not be required to terminate or impose passthru payment withholding on recalcitrant accounts, or impose passthru payment withholding on payments to other FFIs in a country that has an intergovernmental agreement
  - US would not require FFIs in Partner Country to enter into a separate agreement and would eliminate withholding under FATCA on payments to FFIs in the partner country
  - US would commit to reciprocity with respect to collecting and reporting information regarding US accounts of Partner Country residents to the authorities of the Partner Country

# Future Guidance Timeline

- Final Regulations by summer 2012
  - Unlikely to occur due to delay in issuing the proposed regulations
  - It is more likely the case that the final regulations will be issued in Fall 2012, further delaying the date on which withholding tax and information reporting obligations will be imposed
- Model FFI Agreement and FATCA reporting forms will follow a similar timeline
  - The Preamble to the Proposed Treasury Regulations provides that the IRS intends to publish a draft model FFI agreement in early 2012 and intends to publish a final model FFI agreement in the fall of 2012
  - Treasury staff have publicly stated that a Model FFI agreement may be published in April

# Thank You for Participating

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