



American Bar Association

FATCA's Expanding Global Reach: A Concern for Big and Small

January 29, 2016

Moderator: Philip Hirschfeld, Ruchelman P.L.L.C., NY, NY

Panelists

Aída Gabriela Contreras Delgado, Sub-Administrator for International Tax Rulings, Mexican Tax Administration Service, Mexico, D.F

Erica Gut, PricewaterhouseCoopers, San Francisco, CA

Victor A. Jaramillo, Caplin & Drysdale, Washington, DC

Elena Virgadamo, Office of International Tax Counsel, Treasury Dept., Washington, DC



Principal Topics

- Overview of FATCA
- Hot Issues being faced in the Field
- The Common Reporting Standard (“CRS”)
- IRS/Treasury Update – What is expected next
- Reaction from Abroad: The Mexican Assessment
- Questions and Answers from the Audience

Overview of the Foreign Account Tax Compliance Act ("FATCA"): Primarily contained in Code §§1471-1474 (Chapter 4 taxes)



Overview of FATCA

- Purpose – Get Foreign Financial Institutions (“FFIs”) to disclose identity of U.S. customers to the IRS.
- Chapter 4 imposes a 30% withholding tax on “withholdable payments” made to FFIs & NFFEs who are non-compliant.
 - FFI = Foreign banks, custodial institutions, insurance companies & investment entities (e.g., mutual funds, hedge funds, private equity funds).
 - NFFE = Non-Financial Foreign Entity
 - A foreign entity other than an FFI

FFI/NFFE Responsibility

- If an FFI, compliance means:
 - Significant due diligence, reporting & withholding requirements regarding “financial accounts” held by U.S. persons or U.S. owned foreign entities.
 - Global Intermediary Identification Number (“GIIN”) issued

- If a NFFE, compliance means:
 - Passive NFFE - Provide certification to withholding agent as to “substantial U.S. owners.”
 - More than 10% (direct or indirect) U.S. owners
 - With respect to investment companies, any percentage ownership
 - Active/Publicly Traded NFFE – No required disclosure

U.S. Withholding Agents

- Get appropriate Form W-8 from every foreign payee, which addresses both:
 - Chapter 3 30% Withholding Tax &
 - Chapter 4 FATCA Withholding Tax
- Withholdable Payments for:
 - Both Taxes: U.S. source FDAP (e.g., interest, dividends, rents, and royalties)
 - FATCA only: Gross proceeds from sale or exchange of assets giving rise to U.S. source interest or dividends
 - Notice 2015-66: Delayed until after 12/31/18

Intergovernmental Agreement (“IGA”)

- Model 1
 - Reciprocal (e.g. Mexico, Canada) – bilateral exchange between both jurisdictions
 - Nonreciprocal (e.g. Cayman Islands) – unilateral exchange from the foreign jurisdiction to the U.S.
 - Reporting to the local country

- Model 2 (e.g., Switzerland, Hong Kong)
 - Requires local FFI participation directly with the IRS
 - Form 8966, FATCA Report, filed with the IRS
 - More favorable terms than the FATCA regulations

Reporting Obligations on U.S. Persons

- FBAR
 - Form 114, Report of Foreign Bank and Financial Accounts
 - Filed with Financial Crimes Enforcement Network (FinCEN), which is part of the Treasury.
 - Must be filed electronically
- FATCA: Filings with the Income Tax Return
 - Added Form 8938, Statement of Specified Foreign Financial Assets, under Code §6038D
 - Expanded Form 8621, PFIC shareholder filings, under §1298(f)

Hot Issues being faced in the Field

The New Information Reporting Regimes

In addition to FATCA, financial institutions have to deal with two other regimes:

1. UK CDOT: FATCA-like regime for the UK Crown Dependencies and Overseas Territories; &
2. CRS: the Common Reporting Standard
 - effective January 1, 2016
 - designed by the OECD and
 - implemented in waves over the next several years

While the three regimes are similar, there are differences.

Identifying the differences and the relative impact is challenging for organizations working to have a global policy and procedure.

Intergovernmental Agreements (IGAs)

Challenges

- Approximately 110 Model 1 and Model 2 IGA jurisdictions treated as having an IGA in effect
- Local guidance vary by country
- Local country registration requirements
- Local country residency requirements
- Keeping current on the latest developments globally
- Issues with countries whose IGAs have not been finalized
- Development of Common Reporting Standards is affecting compliance

Documentation Issues

- Application of *preexisting* account due diligence (“PADD”) rules
 - Final due diligence for FATCA to be completed by June 30
 - Entity classification and intermediary documentation challenges
- Obtaining *new* account documentation
 - Complex withholding certificates (e.g. IRS Forms W-9, W-8)
 - Varying standards for self certifications in different countries
 - Emerging CRS issues are impacting current documentation rules

Legal Entity Classification

Classifying Legal Entities

- Classification of FFIs versus passive NFFEs
 - Holding companies in investment structures and non-financial entities
 - Issues associated with controlling persons
 - FATF requirements
 - Coordination with AML/KYC
- Classification of US entities
 - Overlay of CRS issues for legal entity classification

Reporting Issues

- Issues with 2014 reporting
 - Systems not ready
 - XML files difficult to get right
 - Transmission of information to IRS resulting in multiple error messages
 - Several countries were not prepared for 2014 reporting
- 2015 reporting
 - More information required – gross income as well as year end balance
 - UK CDOT reporting for 2014 and 2015
 - Reporting for 2014 and 2015 in jurisdictions that did not complete IGA guidance

Governance Issues

Governance & Controls

- Leading practice is to establish or enhance a governance structure with sufficient reach and seniority to ensure comprehensive compliance.
- Many organizations are appointing an officer to be responsible for worldwide compliance with FATCA and other information reporting and withholding matters.
- Organizations are finding it difficult to install and implement internal controls to make certain that policies and procedures are operating as intended, and to prevent, detect and remediate material failures.

Examination Issues

- Information provided to the IRS includes:
 - FBAR filings – highest balance of account during the calendar year
 - Form 8938 filings – maximum value of assets during the tax year
 - FATCA reporting – value of account at year end plus gross income attributable to account determined under local tax principles
- How is the information going to be reconciled?
 - EU requires information to be sent to the account holder, but that is not universally true.
 - Account holder may not have transparency into what is reported.
 - Increased anxiety over data being reported may lead to increased compliance.
 - IRS will have to decide how it will react to information mismatches.
 - Do nothing
 - Correspondence exam
 - Examination

The Common Reporting Standard (“CRS”)

The Standard

- Common Standard on Reporting, Due Diligence, and Exchange of Information on Financial Account Information
 - Works like Model 1 IGA – financial institutions report to government
- Consists of four components:
 - Model Competent Authority Agreement (CAA)
 - The Common Reporting and Due Diligence Standard (CRS)
 - The Commentaries on the CAA and CRS
 - The CRS XML Schema
- Implementation of the standard requires translating the CRS into domestic law
 - Need to ensure consistency in application across jurisdictions
- Jurisdiction must have rules in place requiring financial institutions to report and follow due diligence standard

Implementing the Standard

Four core requirements

1. Translating CRS into domestic law, including rules to ensure their effective implementation and a framework to enforce compliance
 - Anti-abuse provisions
 - Record keeping requirements (compliance)
 - Non-compliance penalties
2. Selecting legal basis for automatic exchange
 - DTAs
 - Multilateral Convention on Mutual Administrative Assistance in Tax Matters
 - TIEA
 - Model Competent Authority Agreements

Implementing the Standard (cont'd)

3. Putting in place IT and administrative infrastructure and resources
 - Process
 - Collecting and reporting the information
 - » Timing (after year end, before Sept.)
 - » Format – XML (virtually identical to FATCA schema in terms of structure and content)
 - Receiving the information to send → Validating data
 - Sending the information
 - » Minimum standards → transmission and encrypting standards
 - » Translation (language)
 - Receiving the information
 - » Confidentiality (using information only for tax purposes)
 - » Building the systems and processes to receive, hold, and exchange information

Implementing the Standard (cont'd)

4. Protecting confidentiality and safeguarding data
 - whether domestic laws require particular data protection and confidentiality requirements
 - Accomplished by domestic law and the international exchange instrument

CRS Overview

- Reporting Financial Institutions
 - Must be an entity
 - Is it a financial institution
 - Like FATCA – Depository Institution, Custodial Institution, Investment Entity, Specified Insurance Co, Non-Reporting FI
 - Which Jurisdiction
 - Tax resident entities – residence for tax purposes
 - Non-tax resident entities, except trusts – place of incorporation, place of management, or where subject to financial supervision
 - Multiple resident entities – place where accounts maintained
 - Trusts – Where one or more trustees are resident, unless the required information is being reported elsewhere because the trust is treated as tax resident there

CRS Overview

- Financial accounts
 - Excluded accounts
 - Reportable accounts –
 - Two Tests:
 - (i) account held by one or more Reportable Persons, or
 - (ii) by a passive Non-Financial Entity (NFE) with one or more Controlling Persons that is a Reportable Person.
 - Reportable Person – an individual or Entity resident in a Reportable Jurisdiction for tax purposes under the laws of that jurisdiction (or where their effective management is if they do not have a tax residence)

CRS Overview

- Passive NFE – not an active NFE
 - Active NFE
 - Excludes:
 - » entities that primarily receive passive income or hold assets that produce passive income;
 - » Investment Entity that is not a Participating Jurisdiction Financial Institution
 - » Includes:
 - » Publicly traded entity (or related entities)
 - » Governmental entities
 - » International Organizations
 - » Central Banks
 - » Holding NFEs of nonfinancial groups

CRS Overview

- If account holder passive NFE, then “look-through” to Controlling Person
 - Controlling Person – “beneficial owner” from FATF recommendations
 - Entity – natural person who exercises control over the entity. If no such person exists, then any natural person that otherwise exercises control over entity’s management (e.g., the senior managing official of the company)
 - Partnership – natural person who exercises control through direct or indirect ownership of the capital or profits of the partnership, voting rights in the partnership, or who otherwise exercise control over the management of the partnership or similar arrangement
 - Trust – the settlor(s), trustee(s), protector(s) (if any), beneficiary(ies) or class(es) of beneficiaries, and any other natural person(s) exercising ultimate effective control over the trust
 - » If the settlor, trustee, protector, or beneficiary is an Entity, the Reporting Financial Institution must identify the Controlling Persons of such Entity

Differences between CRS and FATCA

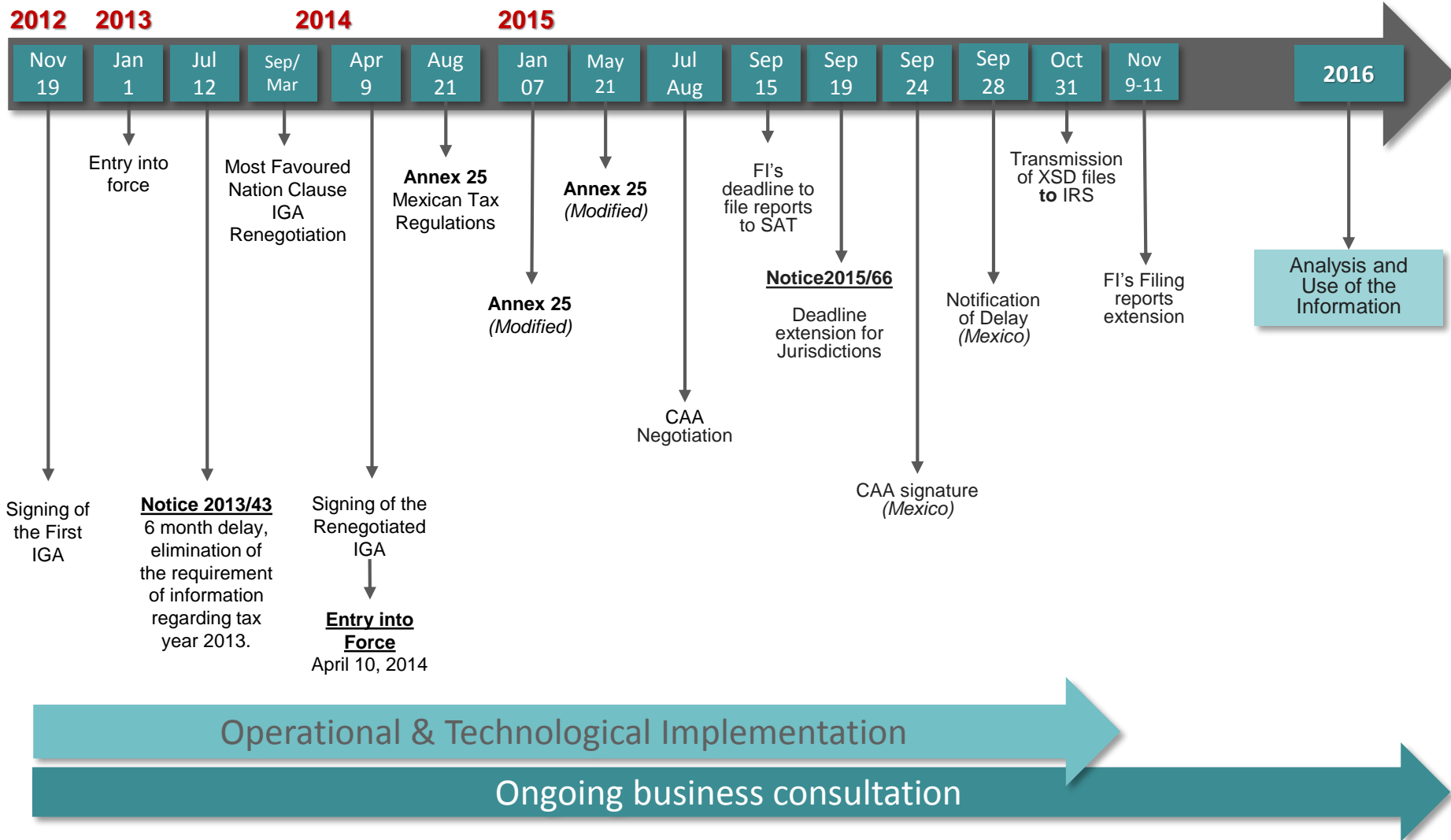
Non-exhaustive list

- Nexus for reporting Financial Institutions
 - CRS uses Residence, FATCA allows partner jurisdiction to define (residence or jurisdiction of organization)
- Investment Entity
 - Definition between the two are different, but CRS designed to achieve equivalent outcome
- Cash Value Insurance Contract
 - FATCA excludes \$50k or lower; CRS does not
- Passive NFEs
 - Controlling Persons – FATCA requires only US Controlling Persons; CRS requires all
 - CRS includes Investment Entity not resident in Participating Jurisdictions

IRS/Treasury Update – What is expected next --- Elena Virgadamo

Reaction from Abroad: The Mexican Assessment -- Aída Gabriela Contreras Delgado

FATCA Implementation Timetable



Implementation Project

FATCA

Legal

Operations

Administrative
Tax
Regulations

IGA

Competent
Authority
Arrangement

Annex 25

Section I
(IGA &
Annexes)

Section II
General and
special rules

Transmission

SCHEMA

Data
Safeguarding
Test

FI Reports
15-09-2015

Transmission
to IRS
October 2015

Analysis and
use of
information

Transmission
from IRS

Desecryption
and cleansing

Analysis and
use of
information

Implementation and Compliance Challenges

Legal

- ✓ Acknowledgement as a Financial Institution
- ✓ Investment entities definition
- ✓ Identification of Controlling Persons
- ✓ *Fideicomisos* (trusts)
- ✓ Interaction with preexisting reporting obligations
- ✓ AML/KYC procedures

Operative

- ✓ GIIN registration
- ✓ W8 and self certification process
- ✓ Due diligence
- ✓ AML/KYC procedures

Technological

- ✓ Technological platform design and development
- ✓ Transmission issues and errors

FI's Compliance Preliminary Assessment

- 615 FI's registered (GIIN).
- 410 certificate requests (these certificates are the key to log into the Mexican platform that will allow the file transmission).
- 222 FI's complied with the obligation to file a report (including nil reports) with the Mexican Tax Administration.
- 1328 files received by the Mexican Tax Administration from Mexican FIs.

Interaction with CRS

- For the implementation of FATCA, it was taken into consideration the fact that CRS was built very closely on FATCA; therefore, the commentaries on the CRS were a useful tool when designing the applicable Administrative Tax Regulations.
- **Investment Entities.-** The Mexican regulations incorporate the CRS commentaries and the US Treasury Regs. in order to include **2 types of investment entities**: those that primarily conduct as a business investment activities or operations on behalf of other persons and entities that are managed by those Entities or other FI. (Commentary on section VIII.15; § 1.1471-5(e)(4)(iii)(A) US Treasury Regs.)

Also, the exceptions for this definition reflect the content of the US Treasury Regs. [§ 1.1471-5(e)(5) – Carve out procedures]

Interaction with CRS

- **Wide Approach:** The Mexican Tax Authority has recommended the FI to adopt a wide approach when developing their due diligence procedures in order to identify not only the US Reportable Accounts but also those of different jurisdictions.
- **Controlling Persons.-** The definition set forth by the Mexican Administrative Tax Regulations relies on the definitions established by the AML procedures and requirements established by the Mexican Authorities.

However, to be consistent with the definition established by the Financial Action Task Force, *the term control will also include an individual who, **directly or indirectly**, acquires or owns **25% or more of an Entity's shares.***

- **Self certifications:** Self-certification requirements should be applicable both for FATCA and the CRS reports.

Questions and Answers from the Audience