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A Layman's Guide to FATCA Due Diligence and Reporting Obligations

by Jean-François de Clermont-Tonnerre, Esq.
Hottinger & Partners, S.A.
and Stanley C. Ruchelman, Esq.[*]
The Ruchelman Law Firm
New York, New York

BACKGROUND

On March 18, 2010, the United States enacted the Foreign Account Tax Compliance Act (FATCA),[1] imposing extensive and unprecedented information reporting obligations on foreign financial institutions (FFIs) with respect to accounts beneficially owned by U.S. persons.[2] These were accompanied by new withholding taxes on U.S.-source income and sales proceeds of U.S. debt and equity securities in order to incentivize compliance.[3]

At the time, the financial community outside the United States derided the reporting obligations, complaining that they were not enforceable and that local law in many jurisdictions prevented compliance.[4] However, on February 8, 2012, the U.S. Treasury Department announced an agreement in principle with France, Germany, Italy, Spain, and the United Kingdom to promote an intergovernmental approach to FATCA implementation.[5] Financial institutions in those countries would report information on U.S.-owned accounts to the tax authorities in their country of residence. In turn, those countries would report information to the United States.[6] This became known as the Model 1 Intergovernmental Agreement (IGA).

Then, on June 21, 2012, joint statements with Japan and Switzerland were announced calling for direct reporting to the United States by financial institutions in those two countries.[7] In Switzerland, this means that Article 271 of the Criminal Code would

[*] Jean-François de Clermont-Tonnerre, Esq., is the managing partner of Hottinger & Partners, S.A. wealth managers. Stanley C. Ruchelman is a member of The Ruchelman Law Firm. The authors acknowledge the contributions of Philip Hirschfeld and Armin Gray, associates at The Ruchelman Law Firm, in the preparation of this article. This article is based on a paper delivered at The Private Client Forum sponsored by Legal Week and held at Lake Como, Italy, on November 15–17, 2012.

[1] P.L. 111-147, §§501–541, 124 Stat. 71 (2010).

[2] §1471(b). All section ("§") references are to the U.S. Internal Revenue Code of 1986, as amended, or the regulations thereunder, unless otherwise indicated.

[3] §1471(a). *See also* §1472(a).

[4] *See, e.g.,* Jolly and Knowlton, "Law to Find Tax Evaders Denounced," *N.Y. Times* (12/26/11), available at http://www.nytimes.com/2011/12/27/business/law-to-find-tax-evaders-denounced.html?pagewanted=all&_r=0.

[5] Proposed regulations were issued the same day. The proposed regulations were finalized on January 17, 2013.

[6] Joint Statement from the U.S., France, Germany, Italy, Spain and the U.K. regarding an intergovernmental approach to improving international tax compliance and implementing FATCA (Feb. 8, 2012), available at http://www.treasury.gov/press-center/press-releases/documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

[7] Joint Statement from the U.S. and Japan regarding a framework for intergovernmental cooperation to facilitate the implementation of FATCA and improve international tax compliance (June 21, 2012), available at http://www.treasury.gov/press-center/

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have to be modified.[8] This became known as the Model 2 IGA.

On July 26, 2012, the U.S. Treasury Department published a prototype Model 1 IGA (with reciprocal and non-reciprocal versions) aimed at facilitating FATCA reporting through the adoption of in-country reporting procedures.[9] Additionally, on September 12, 2012, the United States and the United Kingdom signed the first such Model 1 IGA.[10]

On November 8, 2012, the U.S. Treasury Department announced that it was in discussions with more than 50 countries to adopt IGAs calling for exchanges of information on U.S. persons under FATCA.[11] These countries include France, Germany, Italy, Spain, Japan, Switzerland, Canada, Denmark, Finland, Guernsey, Ireland, Isle of Man, Jersey, Mexico, the Netherlands, and Norway, with whom IGAs had been expected by the end of the year. They also include Argentina, Australia, Belgium, the Cayman Islands, Cyprus, Estonia, Hungary, Israel, Korea, Liechtenstein, Malaysia, Malta, New Zealand, the Slovak Republic, Singapore, and Sweden, with whom dialogues are actively being pursued. The Treasury Department is having discussions with Bermuda, Brazil, British Virgin Islands, Chile, Czech Republic, Gibraltar, India, Lebanon, Luxembourg, Romania, Russia, Seychelles, St. Maarten, Slovenia, and South Africa. Even the Gulf Cooperation Council met with Treasury Department representatives at a meeting hosted by the Qatar Central Bank in early December. Conspicuous by absence are China, Hong Kong, Macau, and the lesser Caribbean jurisdictions.

On November 14, 2012, the U.S. Treasury Department published a prototype of a Model 2 IGA.[12] The Model 2 IGA, which is non-reciprocal, provides for direct reporting to the IRS by any FFI in that country, supplemented by exchange of information between the United States and the foreign government upon request. As indicated earlier, this approach is to be used for Switzerland and Japan, as well as other countries to be determined in future discussions.

On November 15, 2012, the United States and Denmark signed a Model 1 IGA[13] and on November 19, 2012, the U.S. and Mexico signed a Model 1 IGA.[14] On December 4, 2012, the U.S. and Switzerland announced they would sign a Model 2 IGA, and on January 17, 2013, Norway and the U.S. initialed a Model 1 IGA.[15]

Something has happened in the world of global financial institutions. Governments appear to be willing to cooperate in promoting transparency of financial information to promote tax compliance. The reporting ''jinni'' is out of the bottle and he is not returning. In this new environment, the keys for the global financial community are:

- Understanding the FATCA-driven know your customer (KYC) procedures that must be implemented in regard to existing accounts in order to find U.S. persons.
- Understanding the scope of information reporting obligations regarding U.S. accounts.
- Understanding the obligations that exist when dealing with other financial institutions and recalcitrant account holders.
- Understanding the benefits that may be derived if a financial institution is resident in a jurisdiction that has in effect an IGA with the United States.

OVERVIEW — THE WORLD OF FATCA

FATCA was enacted as part of an effort to deny U.S. persons access to FFIs when the institution serves as a repository for the proceeds of unreported income.[16] It does this by placing U.S. reporting obligations on FFIs to report on their U.S. customers and imposes severe penalties in the form of withholding taxes for those who fail to comply. We are concerned with the obligations that FATCA imposes on FFIs. Consequently, we need to define the term. In general,

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press-releases/Documents/FATCA%20Joint%20Statement%20 US-Japan.pdf; Joint Statement from the U.S. and Switzerland regarding a framework for cooperation to facilitate the implementation of FATCA (June 21, 2012), available at http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Switzerland.pdf.

[8] Switzerland Joint Statement, above note 6, Art. II(A)(2).

[9] ''Treasury Releases Model Intergovernmental Agreement for Implementing the Foreign Account Tax Compliance Act to Improve Offshore Tax Compliance and Reduce Burden,'' Treas. Dept. Press Release (July 26, 2012), reprinted in http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx.

[10] *See* U.S.-U.K. IGA, available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-UK-9-12-2012.pdf.

[11] ''U.S. Engaging with More Than 50 Jurisdictions to Curtail Offshore Tax Evasion,'' Treas. Dept. Press Release (Nov. 8, 2012), available at http://www.treasury.gov/press-center/press-releases/Pages/tg1759.aspx.

[12] Agreement Between the United States of America and [FATCA Partner] for Cooperation to Facilitate the Implementation of FATCA, available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-2-Agreement-to-Implement-11-14-2012.pdf.

[13] *See* U.S.-Denmark IGA, available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Denmark.pdf.

[14] *See* U.S.-Mexico IGA, available at http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Mexico-11-19-2012.pdf.

[15] *See, e.g.,* Bart and Schmieder, *Switzerland Agrees on Tax Crackdown Pact with US*, Reuters (12/4/12), available at http://www.reuters.com/article/2012/12/04/us-swiss-tax-fatca-idUSBRE8B30OD20121204. The details of the agreement will be made public once it has been formally signed by the two countries. *See* Stewart, ''U.S. Initials FATCA Agreement with Norway,'' available at *Tax Analysts, Worldwide Tax Daily* (1/18/13).

[16] *See generally* Jt. Comm. on Taxation, Technical Explanation of the Foreign Account Tax Compliance Act of 2009, Oct. 27, 2009, available at https://www.jct.gov/publications.html?func=startdown&id=3596.

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an FFI is a financial institution that is not a U.S. entity.[17] A "financial institution"[18] is an entity that does one or more of the following:

- Accepts deposits in the ordinary course of a banking or similar business; this includes an entity that:
  - Accepts deposits of funds;
  - Makes personal, mortgage, industrial, or other loans;
  - Purchases, sells, discounts, or negotiates accounts receivable, installment obligations, notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness;
  - Issues letters of credit and negotiates drafts drawn thereunder;
  - Provides trust or fiduciary services;
  - Finances foreign exchange transactions; or
  - Enters into, purchases, or disposes of finance leases or leased assets.[19]
- Holds, as a substantial portion of its business, financial assets for the account of others. This will be considered to occur when the gross income attributable to the holding of financial assets is at least 20% of the total gross income during the three-year period ending on December 31 of the year in which the determination is made.[20]
- Is an investment entity.[21]
- Is an insurance company (or the holding company of an insurance company) that issues or is obligated to make payments with respect to a cash value insurance policy or annuity contract.[22]

Exceptions are provided for non-financial holding companies, start-up companies other than investment funds and the like, non-financial companies that are in liquidation or emerging from bankruptcy, and hedging/financing centers of a non-financial group.[23] As can be seen, the definition of "financial institution" is very broad. It encompasses not only banks but also hedge funds, mutual funds, private equity funds, brokerage firms, and certain insurance companies.

FFIs are divided into two groups — participating FFIs (PFFIs) and nonparticipating FFIs (NPFFIs).[24] A PFFI can be identified because it has a Global Intermediary Identification Number (GIIN) (a special tax identification number (TIN) for PFFIs) and the name and GIIN are published by the IRS in a list.[25] A PFFI is an FFI that enters into an agreement with the IRS (FFI Agreement)[26] under which the FFI agrees to undertake specific actions.

First, a PFFI will deduct and withhold tax with respect to passthru payments made to recalcitrant account holders and NPFFIs.[27] A "passthru payment" is any withholdable payment and any foreign passthru payment.[28] The concept of a "foreign passthru payment" is designed to prevent NPFFIs from avoiding FATCA withholding by making indirect investments in the United States through PFFIs that act as FATCA blocker corporations. This is because the payment made to the NPFFI by the PFFI on its equity securities or debt instruments will be foreign-source and thus not a "withholdable payment," which by definition is U.S.-source. However, due to the complexity of the mechanism needed to track and withhold on foreign passthru payments, both the proposed and the final regulations reserve the issue for additional consideration.[29] No rule is currently provided. However, under a prior controversial notice,[30] a portion of a payment to an NPFFI would be subject to withholding on a pro rata basis by applying a "passthru payment percentage" to the payment. Under this notice, the passthru payment percentage would be based on the value of a PFFI's U.S. assets as a percentage of the total assets of the PFFI. More specifically, it would be computed by: (1) determining the sum of the PFFI's U.S. assets held on each of four quarterly testing dates; and (2) dividing that sum by the PFFI's

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[17] §1471(d)(4); Regs. §1.1471-5(d).

[18] §1471(d)(5); Regs. §1.1471-5(e)(i). An entity is not considered to be engaged in a banking or similar business for these purposes if the entity solely accepts deposits from persons as collateral or security pursuant to a sale or lease of property or pursuant to a similar financing arrangement between such entity and the person holding the deposit with the entity.

[19] Regs. §1.1471-5(e)(2).

[20] Regs. §1.1471-5(e)(3).

[21] The term "investment entity" is broad. It includes (i) an entity that primarily conducts as business one or more of the following activities or operations for or on behalf of customers: trading in various securities; portfolio management; or otherwise investing, administering, or managing funds, money, or financial assets on behalf of other persons; (ii) an entity (other than an entity under clause (i) in the preceding sentence) if its gross income is primarily attributable to investing, reinvesting, or trading as an investment entity and only if the entity is managed by a depository institution, a custodial institution, another investment entity, or an insurance company that qualifies as a financial institution; and (iii) an entity that functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets. The final regulations both broadened and limit the scope of the proposed regulations by conforming to the IGAs and excluding from the definition of FFI passive entities that are not professionally managed. Consistent with the proposed regulations, the final regulations also provide that an entity primarily conducts an activity if gross income attributable to such activity equals or exceeds 50% of the entity's gross income. Regs. §1.1471-5(e)(4).

[22] Regs. §1.1471-5(e)(1)(iv).

[23] Regs. §1.1471-5(e)(5).

[24] *See, e.g.,* Regs. §§1.1471-1(b)(75), (85).

[25] Regs. §1.1471-3(d)(4).

[26] Regs. §§1.1471-1(b)(85), 1.1471-4(a).

[27] Regs. §1.1471-4(a)(1), (b).

[28] Regs. §§1.1471-1(b)(89), 1.1471-5(h).

[29] *See, e.g.,* Regs. §1.1471-5(h)(2); Prop. Regs. §1.1471-5(h)(2).

[30] Notice 2011-34, 2011-19 I.R.B. 765, §II, Passthru Payments.

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total assets held on those dates. As will be discussed later, IGAs generally will not require withholding on passthru payments to NPFFIs and recalcitrant accountholders. Instead, the United States and its FATCA country partner will determine alternative ways to prevent abuse of FATCA blockers. It remains to be seen what anti-abuse provisions will ultimately be promulgated.

Second, a PFFI will have to perform due diligence to identify and document the status of its account holders.[31] This requires determining whether the account is a pre-existing account — that is, an old account — or a new account; whether the account is an individual account or an entity account; whether the account is a low-value, mid-value, or high-value account; and whether the account is otherwise exempt from reporting.[32]

The exact due diligence procedures are discussed in more detail later.

Third, the PFFI must report annually to the IRS information related to U.S. accounts and recalcitrant account holders.[33] For accounts held by "specified U.S. persons," the following information must be reported:

- The name, address, and TIN of the account holder;
- The account number;
- The account balance or value;
- Payments made during the year with respect to the account. This includes the aggregate gross amount paid or credited to the account with respect to:
  - Dividends;
  - Interest;
  - The sale or redemption of property;
- Transfers and closings of deposit, custodial, insurance, and annuity financial accounts; and
- Such other information required in the IRS form and its accompanying instructions.[34]

For accounts held by "U.S.-owned foreign entities," the following information must be reported:

- The name of the entity;
- The name, address, and TIN of each substantial U.S. owner;
- The account number;
- The account balance or value of the account; and
- Payments made during the year with respect to the account.[35]

For "recalcitrant account holders," in general the following information must be reported:

- The aggregate number and aggregate value of accounts that have U.S. indicia;
- The aggregate number and aggregate value of accounts that do not have U.S. indicia; and
- The aggregate number and aggregate value of accounts that are dormant accounts.[36]

It should be noted that FATCA allows information with respect to the accounts identified as held by U.S. persons to be reported under existing Form 1099s.[37] Thus, FFIs with a U.S. presence that already have the systems in place can use those systems to report information on its U.S. accounts held in its branches outside the United States. However, FATCA expands the scope of existing 1099 reporting. Under existing 1099 reporting, corporations are generally exempt and no 1099 need be issued to them. FATCA, however, requires reporting under 1099 as if the FFI was a "U.S. person" and "each holder of such account . . . were a natural person and citizen of the U.S." In other words, corporations are treated as individuals for 1099 FATCA reporting purposes.

Fourth, a PFFI must arrange for all affiliates ("members of the Expanded Affiliated Group") to register with the IRS so that "cherry picking" between "clean" and "dirty" business cannot take place.[38] As a result, each FFI in an expanded affiliated group must submit a registration form to the IRS as a condition for any member to become either a PFFI or registered deemed-compliant FFI.[39] A limited exception applies for affiliates that have the character of "limited FFIs."[40] These are affiliates that are prevented by local law from compliance with all FFI requirements. To have the status of a limited FFI affiliate, the affiliate cannot close the account within a reasonable period of time or transfer the account to an affiliate that may report. If the affiliate holds recalcitrant accounts, it cannot block those accounts. The affiliate must register with the IRS, agree to due diligence requirements, retain account holder documentation for six years from registration, report the accounts to the extent permitted under local law, and refrain from opening new U.S. accounts or accounts of NFFIs. In addition, it must identify itself to withholding agents as an NPFFI. The status of a limited

[31] Regs. §1.1471-4(a)(2), (c).

[32] *See* Regs. §1.1471-4(c).

[33] Regs. §1.1471-4(a)(3), (d).

[34] Regs. §1.1471-4(d)(3)(ii).

[35] Regs. §1.1471-4(d)(3)(iii).

[36] Regs. §1.1471-4(d)(6).

[37] §1471(c)(2); Regs. §1.1471-4(d)(5).

[38] Regs. §1.1471-4(a)(4), (e).

[39] Regs. §1.1471-4(e)(1).

[40] Regs. §1.1471-4(e)(3).

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FFI affiliate terminates after December 31, 2015. Similar rules apply to limited branches.[41]

Fifth, a PFFI must obtain waivers of bank secrecy laws to the extent such waivers are allowed and must close accounts of those who fail to waive the benefits of those laws.[42]

Finally, a PFFI must verify internal compliance.[43]

DUE DILIGENCE REVIEW OF ACCOUNTS

Due diligence requires identification and documentation of U.S. accounts. By way of background, the U.S. tax system imposes a self-certification system. For example, U.S. taxpayers file their own tax returns. The law also requires a person to certify whether the person is U.S. or foreign with respect to withholding and backup withholding. Certification means that the person attests that certain facts are true by signing the requisite form under penalties of perjury. FATCA continues with this self-certification system. Thus, the PFFI is required to identify its U.S. accounts and to retain the requisite documents certifying the account holder's status.

For identification of its pre-existing individual U.S. accounts, in general the regulations require that the PFFI review all information collected with respect to the opening or maintenance of each account, including documentation collected for other regulatory purposes to determine whether an account holder has what is referred to as ''U.S. indicia.''[44] For example, if an account holder provides a passport as part of the account opening procedures, the PFFI must review the passport to check for a U.S. place of birth.

In broad terms, U.S. indicia indicate there is some nexus to the United States. More specifically, U.S. indicia include:

- Identification of an account holder as a U.S. resident or citizen;
- U.S. place of birth;
- U.S. resident address or U.S. mailing address (including a U.S. post office box);
- U.S. telephone number;
- Standing instructions to transfer funds to an account maintained in the United States;
- Power of attorney or signatory authority granted to a person with a U.S. address; or
- An ''in-care-of'' address or ''hold mail'' address that is the sole address identified.[45]

If U.S. indicia are identified, a PFFI is required to obtain specific documentation to establish whether the account is a U.S. account.[46] If the account holder is identified as a U.S. resident or citizen, the PFFI must request a Form W-9 and a valid and effective waiver regarding foreign bank secrecy laws.[47]

If the account holder information unambiguously indicates a U.S. place of birth, the participating FFI must request either: (1) a Form W-9 and a valid and an effective waiver; or (2) a Form W-8BEN and a non-U.S. passport or other government-issued identification evidencing citizenship in a country other than the United States.[48] In the latter case, the foreign passport must be accompanied by a Certificate of Loss of Nationality of the United States or Form I-407, or a reasonable explanation of the account holder's renunciation of U.S. citizenship, or the reason the account holder did not obtain U.S. citizenship at birth.[49] In this regard, U.S. law has been modified from time to time over the years regarding acts of renunciation and advice from qualified immigration counsel will be helpful in determining the reasonableness of the explanation.

If the account holder information contains a U.S. address, U.S. mailing address, or telephone number in the United States, the PFFI must request either a Form W-9 and a valid and effective waiver or a Form W-8BEN and a non-U.S. passport or other government-issued identification evidencing citizenship in a country other than the United States.[50] In addition, if the account holder information contains standing instructions to transfer funds to an account maintained in the United States, the PFFI must request either a Form W-9 and a valid and effective waiver or a Form W-8BEN and documentary evidence establishing foreign status.[51] Also, if the account holder information contains a power of attorney or signatory authority granted to a person with a U.S. address or has an ''in care of'' address or ''hold mail'' address that is the sole address identified for the account holder, the PFFI must request either a Form W-9 and a valid and effective waiver or a Form W-8 and documentary evidence establishing foreign status.[52]

If a PFFI has documented an individual account holder as a U.S. person for general foreign person withholding tax purposes or for domestic back-up withholding tax purposes, the account must be treated

[41] *See* Regs. §1.1471-4(e)(2).

[42] §1471(b)(1)(F); Regs. §1.1471-4(i); Prop. Regs. §1.1471-4(a)(5).

[43] Regs. §1.1471-4(a)(5). A PFFI is required to adopt a compliance program under the authority of the responsible officer, who is required to certify that the FFI is in compliance with the requirements of the FFI agreement. The IRS may request additional information to verify compliance with the requirements of the FFI agreement if the IRS identifies concerns about the PFFI's compliance.

[44] Regs. §1.1471-4(c)(5).

[45] Regs. §1.1471-4(c)(5)(iv)(B)(*1*).

[46] Regs. §1.1471-4(c)(5)(iv)(B)(*2*).

[47] *Id.*

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.*

[52] *Id.*

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as a U.S. account.[53] If on the effective date of the FFI Agreement, the account is a small account,[54] documentation as to U.S. status need not be obtained until the value of the account exceeds $1 million at the end of any subsequent calendar year. For this purpose, in general, all accounts maintained by an individual within a group are aggregated, and if accounts are jointly held, each holder is considered to own the entire amount.[55]

Where the account holder is an entity and the account is a pre-existing account, the proposed regulations had indicated that a PFFI must obtain documentation for the account within one year of the effective date of the FFI Agreement if the account holder is a prima facie FFI and within two years for all other entity accounts.[56] However, the IRS delayed the implementation date in Announcement 2012-42. A PFFI will be required to perform the requisite identification procedures and obtain the appropriate documentation to determine whether an entity, other than a prima facie FFI, is itself a PFFI by the later of December 31, 2015, or the date that is two years after the effective date of its FFI agreement. The final regulations are consistent with this approach.[57]

[53] Regs. §1.1471-4(c)(5)(ii).

[54] That is, the account balance or value is $50,000 or less, or in the case of certain pre-existing cash value insurance or annuity contracts of individual account holders, the account balance or value is $250,000 or less.

[55] Regs. §1.1471-4(c)(5)(iii).

[56] Prop. Regs. §1.1471-4(c)(3)(i).

[57] *See* Regs. §1.1471-4(c)(3)(ii).

The obligation to obtain information from an entity is subject to an exception for pre-existing accounts having a balance of $250,000 or less.[58] The ceiling is computed by aggregating all accounts of the entity and affiliates known by relationship managers to be controlled by the same person. Once the small account exception applies, the account need not be documented until it exceeds $1 million in a subsequent year.[59]

The foregoing review of pre-existing individual accounts may be conducted electronically unless the account is a ''high-value'' account, i.e., in excess of $1 million.[60] The FFI is not attributed knowledge of records not kept in the electronic files. However, if an account is a high-value account, all documentation associated with that account must be manually reviewed unless already available by electronic means. This includes recent account opening contracts, anti-money laundering (AML) documentation, powers of attorney, and standing instructions. Changes in circumstances must be taken into account.

The following table summarizes the dates by which withholding agents and financial institutions must fully implement new account opening procedures to identify account holders and the dates by which withholding agents and financial institutions must complete the review and documentation of all pre-existing accounts for purposes of applying the relevant Treasury regulations.[61]

[58] Regs. §1.1471-4(c)(3)(iii).

[59] *Id.*

[60] Regs. §1.1471-4(c)(5)(iv)(D).

[61] Announcement 2012-42, 2012-47 I.R.B. 561.

	New Individual and Entity Accounts (Implementation of new account opening procedures)	**Pre-existing Accounts of Prima Facie FFIs (Date by which due diligence must be completed for all accounts)**	**Pre-existing Accounts of Entities other than Prima Facie FFIs**	**Pre-existing High-Value Accounts of Individuals**	**Pre-existing Accounts of Individuals other than High-Value Accounts**
Withholding Agents other than PFFIs and Deemed-Compliant FFIs	**By Jan. 1, 2014**	**By June 30, 2014**	**By Dec. 31, 2015**	**N/A**	**N/A**
Withholding Agents that are PFFIs	**By later of Jan. 1, 2014, or effective date of FFI Agreement**	**By the later of June 30, 2014, or 6 months after the effective date of the FFI Agreement**	**By the later of Dec. 31, 2015, or two years after the effective date of the FFI Agreement**	**By the later of Dec. 31, 2014, or one year after the effective date of the FFI Agreement**	**By the later of Dec. 31, 2015, or two years after the effective date of the FFI Agreement**
Withholding Agents that are Registered Deemed-Compliant FFIs	**By later of Jan. 1, 2014, or date of registration**	**N/A**	**N/A**	**N/A**	**N/A**

Although the regulations go into mind-numbing detail as to the due diligence required — and, in the guise of alleviating administrative burden, distinguish between old and new accounts, individual and entity

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accounts, and low-value, mid-value, and high-value accounts — the regulations actually make things significantly more complicated and, due to the requirement to monitor the value of accounts, which at a later time may become high-value accounts, it is expected that most FFIs will attempt to disregard most of the distinctions and try to apply a single rule that would be applicable to all their accounts, whether low-, mid-, or high-value.

Furthermore, as a practical matter, it appears that the only course of action that can be implemented to ensure compliance is for the PFFI to perform the requisite due diligence, collect the requisite forms, certifications, and waivers with respect to bank secrecy laws — or not to do business with the account holder — whether the account is low-, mid-, or high-value. In the case of an individual, the appropriate form would be either Form W-9, which certifies that the individual is a U.S. person, or W-8BEN, which certifies that the individual is foreign. In the case of an entity, the appropriate form would be W-8BEN-E. If the individual or responsible person for the entity refuses to certify to the account holder's status, it is expected that most PFFIs will simply close the account (in the case of an old account), or, in the case of a new account, refuse to open it, rather than determine whether an exception applies.

FATCA IGAs

As the prior discussion demonstrates, the due diligence obligations imposed on FFIs are daunting. The process is directed at indicia of U.S. citizenship or tax residence and is not identical with current AML and KYC procedures. Partly to address these issues and to limit needless expense for the financial services industry, the U.S. Treasury Department developed the IGA.

As stated earlier, the Model 1 IGA has both reciprocal and non-reciprocal versions. Under the reciprocal version, the United States and the FATCA partner country share information on each other's tax residents who hold financial accounts in the other jurisdiction.[62] Under the non-reciprocal version, only the United States would receive information on its tax residents holding accounts in the other jurisdiction.[63] The Model 1 IGA is intended to facilitate compliance with FATCA obligations through a reporting mechanism administered by the home country tax administration. Once collected, the information is automatically exchanged with the IRS pursuant to an existing exchange of information agreement.

Also as mentioned earlier, the Model 2 IGA is designed to accommodate countries like Japan and Switzerland that prefer a system of direct reporting to the IRS by FFIs, but otherwise want the benefits of the Model 1 IGA.[64] (A system is also under consideration for use by jurisdictions that have neither a Tax Information Exchange Agreement in place with the United States nor a comprehensive income tax treaty containing an exchange of information provision.)

In many ways, IGAs have softened the process adopted by the U.S. Congress in order to promote compliance through cooperation.[65] The success is measured by the number of countries that are in discussion with the Treasury Department regarding IGAs. As already noted, the Treasury announced that it is in discussion with 50 other countries to adopt IGAs.[66] Some of the important aspects of IGAs are highlighted below.

An IGA permits a financial institution in a FATCA partner country to be a PFFI even if an affiliate or branch in a third country is prohibited by applicable law from providing information to the IRS.[67] This provision should allow an FFI based in a FATCA partner country to consolidate U.S. customers in one office without facing a terminal date for the office when the limited branch and limited FFI affiliate rules terminate after 2015. However, this rule cannot be abused to promote U.S. noncompliance.

An IGA will replace the requirement that an FFI report any 10% U.S. owner of non-publicly traded passive non-financial foreign entities with a requirement that information be reported with regard to a U.S. person who controls the entity.[68] Control will be determined by reference to the Financial Action Task Force Recommendations standards on combating money laundering.[69]

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[62] Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA, available at http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf.

[63] Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA, available at http://www.treasury.gov/press-center/press-releases/Documents/nonreciprocal.pdf.

[64] Joint Statement from the U.S. and Japan regarding a framework for intergovernmental cooperation to facilitate the implementation of FATCA and improve international tax compliance (June 21, 2012), available at http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Japan.pdf; Joint Statement from the U.S. and Switzerland regarding a framework for cooperation to facilitate the implementation of FATCA (June 21, 2012), available at http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Switzerland.pdf.

[65] The U.S. Treasury Department has taken the position that an IGA is an executive agreement — not a treaty, which would require the advice and consent of the U.S. Senate. Whether this is appropriate for an agreement that modifies U.S. domestic law is open to question. Interestingly, most IGA partner countries appear to be taking the position that an IGA is subject to the partner country's normal ratification procedures for treaties.

[66] "U.S. Engaging With More than 50 Jurisdictions to Curtail Offshore Tax Evasion," Treas. Dept. Press Release (Nov. 8, 2012), available at http://www.treasury.gov/press-center/press-releases/Pages/tg1759.aspx. As noted above, the U.S. and Swiss negotiators entered into an agreement in principle on Dec. 4, 2012. The details of the agreement will be made public once it has been formally signed by the two countries.

[67] Reciprocal Model, Art. 4(5).

[68] Reciprocal Model, Art. 2(2)(a)(1).

[69] Reciprocal Model, Art. 1(nn) (definition of "Controlling Per-

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Also, an IGA will eliminate the imposition of withholding tax on passthru payments to a recalcitrant account holder.[70] There will no longer be the need to close the account of a recalcitrant holder.[71] However, FFIs who are in ''significant'' noncompliance for 18 months will not receive the benefit of the IGA and will be subject to FATCA withholding.[72] The process for decertification is jointly carried out by the United States and the FATCA partner country.

Under an IGA, passive ''home offices'' and family trusts are not FFIs, although they may have to enter into an agreement with the IRS, if the final IRS regulations are not conformed to the terms of the IGA.[73] Hedge funds will clearly be FFIs. However, tracking stock and similar instruments that fluctuate in value with the performance of U.S. assets are not financial accounts; thus, no reporting is required.

A Model 1 IGA will allow the reporting of the amount and character of payments to be made in accordance with the law of the FATCA partner country.[74] Although the U.K. IGA substantially conforms to the prototype for the Model 1 IGA (reciprocal version), one notable difference, originally, was the presence of a ''most favored nation'' clause. The most favored nation clause was added to the Model IGAs as last revised on November 14, 2012. This clause[75] generally provides that if the United States enters into another IGA with more favorable terms than the U.K. Agreement, the United Kingdom automatically is granted the benefit of the more favorable terms.

A global financial institution that does business in many jurisdictions could, along with its affiliates, be subject to the FATCA statutory provisions and also several different IGAs, which may have separate rules (unless possibly each IGA has a most favored nation clause similar to that in the U.K. IGA). This could cause massive compliance headaches and unnecessary expense for global financial institutions, unless such institutions attempt to apply a single — most stringent — procedure that would comply with all the different IGAs in place. Anecdotal information indicates that, at least in theory, the Treasury Department has a ''one size fits all'' approach for IGAs. This limits negotiation to the reciprocal and the non-reciprocal versions of the Model 1 IGA and to the Model 2 IGA.

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son'').

[70] Reciprocal Model, Art. 4(2).

[71] *Id.*

[72] Reciprocal Model, Art. 5(2).

[73] *See* Reciprocal Model, Art. 1(g) (definition of a ''Financial Institution'' is narrower than that in the proposed regulations and would not encompass these entities).

[74] Reciprocal Model, Art. 3(1).

[75] U.K. IGA, Art. 7.

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CONCLUSION

The FATCA legislation presents significant implementation problems for the financial services industry outside the United States. The due diligence requirements go beyond that which we have learned to live with under AML and KYC requirements. In comparison to the judgments that must be made under FATCA in reviewing existing account information, the AML/KYC process of reviewing a passport and looking at a utility bill appears relatively simplistic. Those institutions fortunate enough to be resident in a jurisdiction that is actively pursuing an IGA have a path available to comply with limited difficulties. For them, creating a U.S.-directed team and directing all U.S. clients to that team makes eminent sense. For those not fortunate enough to be resident in a FATCA partner jurisdiction, IGAs may allow affiliates and branches operating in FATCA partner jurisdictions to qualify for IGA benefits. They would be well served to pursue that opportunity.

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