



FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) IMPLICATIONS FOR BANKS

Reflecting measures by the US Government to raise tax revenues, the Foreign Account Tax Compliance Act (FATCA) was enacted into law on 18 March 2010. FATCA will impose a 30% withholding tax, not only on US source income but also on redemptions of principal, for Foreign Financial Institutions (FFIs), unless the FFI enters into an agreement with the IRS and reports its U.S. customers.

With implementation due from 2013 onwards, FATCA will place major demands on any bank with US investments and individual account holders who are – or might be – US citizens. Compliance is made even more difficult by the fact that FATCA's requirements – which are still not finalised – may conflict with local laws and banking codes.

This background document summarises the main points of FATCA and answers a number of questions raised by banks which are considering how to respond to its potential impact on their businesses.

Important notice: this document is intended as an introduction to the implications for banks of the Foreign Account Tax Compliance Act. As a summary of complex legislation which has still not been finalised, it cannot capture all aspects of the original Act and the subsequently released Notice 2011-34.

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Background

The Hiring Incentives to Restore Employment (HIRE) Act was signed into law by President Obama on March 18, 2010. The Hire Act includes a number of provisions known as the **Foreign Account Tax Compliance Act (FATCA)**.

On April 8, 2011, the IRS released **Notice 2011-34** Supplemental Notice to Notice 2010-60 Providing Further Guidance and Requesting Comments on Certain Priority Issues Under Chapter 4 of Subtitle A of the Code. This expands on a number of issues covered in the original FATCA legislation. Of particular concern to banks are the detailed provisions for gathering information from private banking customers (Section I) and the requirements for banks to make FATCA-related deductions for non-compliant customers from income which does not derive from US investments, or so-called “Passthru payments”(Section II).

A further **Notice 2011-53**, issued on July 14, 2011, delays certain implementation aspects and specifies that withholding will start from January 1 2014. However, FFIs must enter into an agreement with the IRS by **June 30, 2013**.

FATCA has some similarities to the IRS Qualified Intermediary (QI) Program, which was established in 2001 and which eventually involved more than 7000 foreign banks applying for QI status. However, it does not replace QI, but adds another complex layer of obligations.

“IRS has been mining and scouring data that it received from the voluntary disclosure program and has identified numerous banks, advisors and promoters in foreign countries that may have helped taxpayers park assets offshore”

Douglas Shulman
Commissioner of US Internal Revenue

While there are significant parallels, there are also many differences. QI deals with investments only and concentrates on non-US citizens. FATCA deals with a wide range of US assets and specifically concentrates on **US citizens and US persons** (see below for definitions). It places an obligation on Foreign Financial Institutions (FFIs) to gather an unprecedented range of information on all customers who are US citizens and US persons.

What has led to FATCA being enacted?

Almost all US citizens, even those living outside the US, are required to file US tax returns on an annual basis. The IRS and the US Department of Treasury have long held powers to penalise US citizens who fail to comply with relevant legislation.

By most countries’ standards, the penalties which apply are quite draconian, **even if no tax may actually be payable because of the provisions of double tax treaties**.

For example, failure to file details of foreign bank accounts (to be submitted on an FBAR, or Foreign Bank Account Report), can result in a fine of \$10,000 per account per annum for up to six years. **As a result, a US citizen with five bank accounts failing to file US tax returns could be liable for fines of up to \$300,000, even if no tax turns out to be payable** and each account has a minimal balance .

The need to raise additional taxes, coupled with the fact that less than half a million of the estimated 7 million US citizens living outside the US do file returns, has led to FATCA being enacted. An additional attraction is that the cost of identifying potential taxpayers can be pushed onto the FFIs, which by definition are not US entities.

The IRS was offering a very generous voluntary disclosure program for overseas taxpayers who are currently in default of their obligations. However, this expired in September of this year.

What is a Foreign Financial Institution?

The three main categories of FFI identified are those which:

- accept deposits;
- hold a substantial portion of their assets for the account of others; or
- are in the primary business of investing, reinvesting, or trading in securities.

As a result, FFIs are likely to include **banks, credit unions; broker-dealers; trust companies and trusts; mutual funds; funds of funds; exchange-traded funds; hedge funds; insurance companies providing investment products; private equity and venture capital funds; other managed funds; commodity pools and other investment vehicles.**

What is a US Account?

Any financial account held by a US person, or a US owned foreign entity.

Who is a US person?

The category is very widely drawn and includes:

US Citizens:

- Persons born in the US
- Persons who have adopted US Citizenship
- Persons with a US Citizen parent who (with certain exceptions)

US Residents:

- Green Card holders
- Tax Residents

US Entities:

- Corporations
- Partnerships
- Trusts



“If you are a US individual holding overseas assets, you must report and pay your taxes or we will be increasingly focused on finding you”

Douglas Shulman, IRS

What is a US owned foreign entity?

- A corporate entity with a US person who owns 10% or more of the vote or value (directly or indirectly) of the corporation. Note that exemptions exist for publicly quoted and traded companies.
- A partnership where any US person owns (directly or indirectly) 10% or more of the profits, interest or capital interest of the partnership.
- Any grantor trust or other trust in which any US person owns, directly or indirectly, a beneficial interest in the trust.
- For all entities that are FFIs because they are in the primary business of investing, reinvesting, or trading in securities (i.e. all funds), the 10% US person becomes any US person.

Implementation dates

FATCA requirements are being phased in over a period that starts with a requirement to reach agreement with the IRS by **June 30, 2013** and to start reporting and make withholdings on US source dividends and interest from **January 1, 2014**.

The next major date is **January 1, 2015** when various transitional requirements fall away and full reporting under FATCA is required.

The requirement for reporting to start as of January 2014 means that most banks should already be starting their planning for the steps which will be required to gather, organise and report the necessary data to the IRS. In many cases, this will involve changes to internal systems with a significant lead time. However, the considerable uncertainties which still exist (see below) mean that banks cannot yet make a full start on their responses to the demands placed on them by FATCA.

What does becoming an FFI involve?

If an institution decides to become an FFI, it will sign an agreement with the US IRS which obliges the institution to:

- Identify all US citizens and persons who are its clients (subject to certain exemptions and cut-off points);
- Report information annually to the US IRS on receipts, payments and balances for its US citizens and persons;
- Deduct 30% tax on payments to accounts held by “recalcitrant” customers (see below); and
- Require its customers who are US citizens or persons to sign waivers enabling the FFI to report information to the IRS.

For larger groups, the provisions of FATCA will apply to affiliates which are more than 50% held, with a “lead FFI” taking responsibility for submitting applications on their behalf.

Certain FFIs can be treated as “deemed-compliant” if they are banks which meet a series of tests to show that the focus exclusively on domestic business and clients. The IRS is soliciting comments on how FFIs can demonstrate that this is the case.

But disclosing such information on US citizens and persons breaches banking legislation or confidentiality obligations in my country

If a foreign law or regulation prevents the reporting of information, the FFI must obtain an effective waiver of such foreign secrecy law from each US account holder, and if not received in reasonable time, close the account. In fact, this raises two major issues:

In many jurisdictions, an individual account holder may not have the power to waive the FFI’s obligations to comply with relevant legislation in its country of operation. In addition, FFIs’ abilities to require a customer to close an account may be limited by law and/or industry codes of practice.

What happens if my customers do not comply with the FATCA requirements?

Where the holder of an account declines to reveal the identity of the recipient or to certify that it does not have a substantial US owner (a “recalcitrant account”), the FFIs should deduct and withhold 30 percent tax on any withholdable payments (see below) to the recalcitrant account holder.

Many of my customers have a mix of US and non-US investments

The Passthru provisions of Notice 2011-34 set out an approach to be adopted by FFIs based on the ratio of US assets to total assets. The calculation and administration of this approach will raise significant issues for many FFIs. The British Bankers Association has stated that the provisions in their current form would “...create huge administrative burdens for investors..., intermediaries and the IRS”.

What happens if I do not become a FFI?

Your institution will suffer a 30% withholding tax on all withholdable payments – this includes payments of US income (i.e., interest, dividends, royalties, etc.) and a 30% withholding tax on the total proceeds of sale of any US asset (i.e. principal as well as interest payments).

Why don't I just close all my accounts for US customers and submit a nil return?

This may be a reflex response, but FFIs that hold any US assets or access US capital markets still need to be able to show that they have gone through the process of identifying their clients who are US citizens or persons, otherwise they will be treated as non-compliant and suffer a 30% withholding tax on all US income and sale proceeds, even if they have no US clients.

FFIs taking this approach therefore risk a significant loss of revenue while still incurring most of the costs associated with FATCA compliance.

What should I be doing now?

While there are still many important issues to be clarified by the IRS, FFIs should bear in mind that agreements between FFIs and the IRS are required by June 2013 (i.e., only 18 months away).

From an external perspective, FFIs should be consulting with their industry associations and regulators so as to ensure that comments on the IRS's proposed approaches are fed back to the IRS as soon as possible.

From an internal perspective, FFIs should already be planning a scoping or mapping exercise to:

1. Identify which parts of the FFI deal with US citizens or persons.
2. Determine what information on clients is currently held by the FFI and to what extent this captures what will be required under FATCA.
3. Establish what steps will be required to fill the gaps identified under 2.
4. Determine what information on receipts, payments and balances for US citizens and persons is available under the FFI's current systems.
5. Establish what systems changes will be required to gather, store and report the necessary data under 2 and 3.
6. Establish what systems changes will be required to generate the data required under 4.

FFIs should also bear in mind that a specific focus on “Private Banking Accounts” is required by Section I of Notice 2011-34.



THE GBRW/US Tax/TTI CONSORTIUM

Responding to FATCA will present banks and other FFIs with a complex mix of tax, business and systems challenges which will cut across organisational structures. In order to help address these challenges, GBRW, US Tax and Financial Services and Tax Technologies Inc have formed a consortium to provide support across a range of sectors. The consortium is able to provide banks and financial institutions with a fact finding and scoping exercise that will highlight implications for business units, what information is available and what is still required and the systems implications. The scoping report highlights what needs to be done, discusses implementation steps and gives an indication of potential revenue and cost implications.

GBRW LIMITED (LONDON)

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GBRW's management team is based in London, Washington and Singapore and has carried out consulting assignments in more than fifty countries.

GBRW maintains a large database of experienced professional consultants, from whom it selects support for project teams. GBRW "leads from the front" with one or more Directors heavily engaged in each project. GBRW employs no juniors; all consultants are senior professionals with many years of practical experience.

US TAX & FINANCIAL SERVICES LTD (SWITZERLAND & LONDON)

Commonly known as US Tax, an organisation of US tax lawyers, tax accountants and consultants that has 25 years of experience specializing in all aspects of US taxation from the simple to the most complex of scenarios.

Additionally US Tax has very significant experience in designing and managing large scale change programmes within complex international organizations.

US Tax has three principal lines of business:

- Tax planning and consultancy for high net worth individuals, trusts and estates and corporate entities. (inbound and outbound)
- Tax rectification, compliance and management of voluntary disclosures.
- Institutional advice and implementation consultancy to the financial sector.

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TTI has succeeded in an oligopolistic business of high-end corporate tax software and continues to succeed through innovations and its focus on providing excellent solutions to its clients. Its client base includes a number of first-tier US financial institutions.

Further information

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