FATCA: The final regulations have landed — let the games begin

By Anthony Quinn

In January the United States Treasury Department released the final regulations relating to the U.S. Foreign Account Tax Compliance Act (FATCA) on the Federal Register. The final regulations came almost 12 months after the proposed regulations were first issued for consultation. The final regulations cover 544 pages, the majority of which comprises sections 1471 to 1474 of the Internal Revenue Code (which is also referred to as Chapter 4). Within the final regulations there are 115 pages alone dedicated to summarising the key changes that the U.S. Treasury Department has either adopted or chosen to overlook.

Taking into consideration the sheer scale of comments received, it is fair to say that the U.S. Treasury Department and the Inland Revenue Service (IRS) have listened to industry concerns. They have responded accordingly by making a number of significant concessions that will make compliance with the FATCA regulations somewhat easier.

The final regulations address the majority of major items specified in the proposed regulations and notably adopt a targeted, risk-based approach. This is aimed at limiting the scope of impacted entities; expanding the methods for acceptable new customer due diligence and pre-existing account remediation; and providing greater clarity on the majority of issues.

The final regulations contain a number of significant concessions (some of which were originally announced in Notice 2012-42), which will undoubtedly be welcomed by financial institutions, industry associations and independent lobbyists who raised many of these issues during the consultation period. While the release of the final regulations provides financial institutions with additional guidance and greater clarity on the majority of issues, there were also a number of issues that were either held over, open for further comment or received no comment whatsoever, meaning that these suggestions were not adopted.

This article will cover the key elements of the final regulations, including:

- Intergovernmental agreements (IGAs)
- Expansion of grandfathering provisions
- Revision of FATCA definitions
- FATCA registration and certification process
- Customer due diligence
- Pre-existing account remediation
- Withholding
- Reporting

Intergovernmental agreements (IGAs)

Up until the end of January 2013, there were only five countries that had signed an IGA, well short of the 15 that the IRS announced they expected to have signed by the end of last year. Further IGA announcements are expected over the coming months, including with Australia, a draft of which has been discussed between the Australian Treasury and U.S. Treasury.

The table below outlines the countries that have signed or are expected to sign an IGA.

FATCA: Intergovernment Agreements (IGAs)

Countries that have signed the IGA	Countries that were expected to sign by 31 December, 2012	Countries actively engaged in discussions as at 31 December 2012	Other countries exploring IGA discussions
United Kingdom	France	Argentina	Bermuda
Denmark	Germany	Australia	Brazil
Mexico	Italy	Belgium	British Virgin Islands
Switzerland	Spain	Cayman Islands	Chile
Ireland	Japan	Cyprus	Czech Republic
	Canada	Estonia	Gibraltar
	Finland	Hungary	India
	Guernsey	Israel	Lebanon
	Isle Of Man	South Korea	Luxembourg
	Jersey	Liechtenstein	Romania
	Netherlands	Malaysia	Russia
	Norway	Malta	Seychelles
		New Zealand	Saint Maarten
		Slovak Republic	Slovenia
		Singapore	South Africa
		Sweden	

Correct as at: February 12, 2013

Expansion of grandfathering provisions

Under the final regulations, a grandfathered obligation is one that is outstanding on January 1, 2014. The definition of grandfathered obligations has been expanded and now includes an obligation that gives rise to a withholdable payment that is a dividend equivalent payment. The final regulations also explain that a premium paid with respect to insurance or annuity contracts is also a grandfathered obligation.

Revision of FATCA definitions

In section VI of the preamble, the final regulations further expand and clarify the definitions applicable in s1.1471 of the FATCA regulations which, broadly speaking, has reduced the scope and applicability of certain financial account definitions. PFFIs should now start to revisit their product scoping assessments to determine the impact of these new announcements. The final regulations also introduce new definitions of a financial account, including stating that "a credit balance with respect to a credit card account issued by a credit card company is a depository account". Until the final regulations were issued, these were excluded from scope.

Unless the Australian industry can put forward a compelling argument as to why they should be excluded in Annex II of the IGA, credit cards will remain in-scope.

Most credit card companies allow clients to retain positive balances, and in some cases there may be no limit to the extent that the account can be in credit, meaning that if credit cards were to be exempted they would remain an ideal vehicle for tax evaders to park funds. Having said this, significant credit balances should attract attention under AML/CTF monitoring. It is doubtful that an exemption would be granted based on the strength of the current argument that financial institutions do not pay interest on positive credit card balances and therefore should not be of interest to the IRS.

The issue now facing credit card companies (and the software vendors they rely on), is whether to await the outcome of Australia's IGA submission or to start developing business requirements in preparation for the January 1, 2014, deadline for new customer on-boarding.

The other notable point in respect to the expansion of FATCA definitions is the registered deemed-compliant FFI category, which now includes sponsored FFIs and qualified credit card issuers. The certified deemed-compliant FFI category was also expanded to include limited life debt investment entities.

FATCA registration and certification process

Further clarification has been provided around timing, in relation to the FATCA registration process by Participating FFIs and Registered Deemed Compliant FFIs. The IRS stated its intention to publish the first IRS FFI list on December 2, 2013, with monthly updates to follow. The registration system will be available no later than July 15, 2013, and to be included in the first IRS FFI list registration must be complete by October 25, 2013.

After registration is complete the IRS will issue a unique Global Intermediary Identification Number (GIIN), which will be used by FFIs to establish their Chapter 4 status for withholding purposes and to identify the institution for reporting purposes. In addition to clarification on registration timelines, the final regulations also provide further clarity on the roles and responsibilities of the FATCA Responsible Officer with respect to providing ongoing compliance certifications.

Organisations that have not started assessing which legal entities meet the definition of a "financial institution" or commenced discussions about how FATCA will be included within the broader risk and compliance framework and who will perform the role of the FATCA Responsible Officer, then FFIs should probably start having these conversations soon.

In addition, the final regulations outline in reasonable detail the circumstances that define an "event of default" and emphasise that a default will not result in automatic termination of the FFI agreement. Instead, the IRS will deliver a "notice of default" to the PFFI and allow them to develop a plan to remediate. Only where the PFFI either fails to respond to the event of default or comply with the agreed-upon remediation plan may the IRS consider terminating the agreement. The IRS also clarified what it considers to be a material breach.

Customer due diligence

The final regulations formalised the alignment of the implementation date for FATCA customer onboarding for new customers of both U.S. and non-U.S. withholding agents (including FFIs), to be January 1, 2014. Broadly speaking, this obligation compels U.S. and non-U.S. withholding agents to identify the FATCA status of their payees/customers, which will typically be obtained from existing identification documentation held on file by the withholding agent as a result of existing anti-money laundering (AML) obligations.

The final regulations set out detailed standards for customer due diligence for both individual and entity accounts. Where the withholding agent does not hold sufficient information to allow them to assign an appropriate FATCA status, they may rely on existing documentation collected for regulatory purposes (i.e., AML/KYC), documentation available in the public domain or obtain a signed self-certification from the customer.

The final regulations expand the acceptable methods by which self-certification can be obtained including a non-IRS substitute form in lieu of a U.S. withholding certificate (i.e., W-8BEN, W-8BEN-E, W-8ECI, W-8EXP, W-8IMY and W-9) to determine the FATCA obligations in respect of customer identification, withholding and reporting. Should FFIs wish to continue to use withholding certificates to meet this obligation they will be relieved to learn that the W-8 forms, which currently expire at least every three years, will remain valid indefinitely.

Customer due diligence for new individual account holders is expected to be relatively straightforward, by comparison, as in the event that the withholding agent does not hold "industry classification code" within their customer records, trying to explain and then obtain a self-certification of FATCA status among the 40+ categories is likely to be problematic.

Pre-existing account remediation

The final regulations in respect of pre-existing obligations remain largely unchanged. Both U.S. and non-U.S. withholding agents (including PFFIs) may treat accounts opened prior to January 1, 2014, as pre-existing obligations, meaning that PFFIs must take an extract of active customers that hold FATCA "financial accounts" as at December 31, 2013, and apply the pre-existing account remediation rules with respect to account classification, electronic review and relationship manager inquiry.

One concession that was granted was that new accounts of a customer that has a pre-existing obligation could be treated as a pre-existing obligation provided that the withholding agent or FFI maintaining the account also treats the new obligation and prior obligation as one obligation. Another concession, which may have limited impact, applies where a PFFI is able to electronically review client records including all of the U.S. indicia in lieu of having to perform a paper-based review for high-value individual account holders. This concession is not likely to apply to many PFFIs as the electronic search criteria includes attributes such as place of birth, countries of citizenship and nationality, which are largely not required under existing AML/CFT laws.

Another noteworthy point is that the alternative proposition with regard to higher-value account holders (i.e., aggregate account balances greater than US$1 million) was not adopted by U.S. Treasury. This had originally proposed verifying whether these accounts were U.S.-held accounts by performing electronic identification verification against U.S. data sources (i.e., electoral roll, phone records and property files), prior to having to conduct a paper-based search. As the final regulations fell silent on this point, FFIs still face a significant administrative burden in having to review paper-based files going back five years to identify U.S. indicia that may have remained undetected from electronic record searches.

For pre-existing entity obligations, PFFIs are required to assign a FATCA status for all entity accounts with aggregate balances greater than US$250,000. It is anticipated that the primary method for achieving this will be to apply a "proxy" mapping between the industry classification code and the FATCA status definitions. However, this relies on PFFIs in capturing this data and recording it accurately against the client's record, which for some may prove problematic. Organisations that encounter this problem should consider trying to reverse engineer the industry classification code using data that may already be available, including company names and company registration numbers.

Many large financial institutions are likely to maintain hundreds of thousands of accounts with aggregate balances that exceed the de minimus threshold, and thus are facing a significant "entity classification" clean-up if industry classification codes are not currently part of the data collection requirements.

Withholding

The final regulations specifically mention that if a FFI operates in a country that has entered into an intergovernmental agreement, specific parts of the final regulations (i.e., withholding) do not apply. This is expected to be the case once Australia has signed the IGA.

Reporting

The final regulations did not provide much further detail in respect of reporting other than to reiterate the types of accounts, which are considered "U.S. Reportable Accounts" and the timing for reporting. There are still a significant number of unresolved issues that require further guidance from domestic tax authorities in respect of reporting data requirements and level of reporting required, for example, whether reporting will be required to be consolidated across all "financial institutions" within the Expanded Affiliate Group, or whether reporting would be required at a "financial institution" or "financial account" level. It is expected that once an IGA is signed that this level of detail will need to be negotiated between industry and the domestic tax authority.

Next steps

Wayne Swan, the Australian Treasurer, announced in November that Australia had entered into formal discussions with the U.S. regarding an IGA. The industry has since provided a draft IGA agreement complete with proposed carve-out and exclusions in "Annex II", which the Australian Treasury is understood to have discussed with representatives of the U.S. Treasury Department at a G20 conference in Paris mid-February. So, the message is, watch this space.

Anthony Quinn *is an independent management consultant with more than 17 years' experience as a programme and project manager, responsible for running large-scale transformation change programs for many investment and retail banks in Australia, Europe the U.K. and U.S. Anthony held the position of programme manager for the Anti-Money Laundering and Counter-Terrorism Financing (AML/CTF) program for the banking and financial services group, within Macquarie Bank for four-and-a-half years. Anthony now works as a FATCA programme manager for an investment bank and is the director of www.financialcrimesconsulting.com, providing products and services related to financial crime prevention.*

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