FATCA: spotlight on the Model IGA

By Anthony Quinn

In February 2012, when the US Treasury issued the proposed Foreign Account Tax Compliance Act (FATCA) regulations, it was accompanied by a joint statement by five European countries that announced their intention to become FATCA Partner countries by signing a memorandum of understanding (MOU) with the US Treasury Department.

In late June 2012, Switzerland and Japan announced that they too would join the UK, France, Italy, Germany and Spain in becoming FATCA Partner countries but at that stage, apart from a brief MOU template, the precise details of what this would contain were vague.

On 26 July 2012, US Treasury announced the much anticipated, Model Intergovernmental Agreement (Model IGA), which outlined an alternative model to facilitate compliance with FATCA, which was a positive development.

In response to increasing pressure and growing concerns from Australian financial institutions regarding the impact of FATCA on them and the Australian economy as a whole, the Australian government announced[1] that it is "exploring the feasibility of an intergovernmental agreement with the U.S. with the objectives of minimizing compliance costs for Australian stakeholders, while enhancing the existing tax cooperation arrangements between Australia and the U.S." Industry had to provide comment by 28 September 2012.

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The Model IGA will form the basis of bilateral intergovernment agreements between jurisdictions that wish to adopt this alternative means of complying with FATCA. Under an IGA, "Reporting Financial Institutions" (Reporting FIs) that are resident in a "FATCA Partner" country will be allowed to register

with the domestic "competent authority"; comply with a far simpler due diligence standard; avoid withholding entirely and provide simplified annual reporting on certain "US Reportable Accounts".

The Model IGA introduced new terms, concepts and timeframes. In this article we will discuss the following:

- key changes from the proposed regulations under a Model IGA
- overview of the FATCA requirements under a Model IGA
- commencement date of FATCA under a Model IGA
- summary of the main concessions afforded to Reporting FIs in Model IGA countries
- recommended next steps.

Key changes from the proposed regulations under a Model IGA

The Model IGA provides an exemption from complex and costly withholding obligations, along with a few lesser concessions. However, the additional obligations for customer due diligence on new individual and entity accounts, pre-existing account remediation and reporting of certain US Reportable Accounts remain broadly unchanged.

The changes contemplated in the Model IGA include the following, which will be discussed in turn:

- changes to the concept of foreign financial institution ("FFI") registration
- alignment of thresholds in respect to "controlling persons"
- removal of superannuation products
- further commitments required by Model IGA governments
- enforcement process where obligations are not being met.

Changes to the concept of FFI registration

Under the Model IGA, every financial institution within the FATCA Partner country would become either a Reporting FI or a "Non-Reporting Financial Institution", which is the status reserved for deemed-compliant, exempt or excepted FFIs.

FFIs will no longer be required to register with the Internal Revenue Service (IRS), which also indicates the removal of the concept of a non-participating FFI opting out of FATCA.

Alignment of thresholds in respect of "controlling persons"

Previously, FATCA proposed the introduction of a "substantial US person" test at 10% or more of issued share capital, which varied in threshold terms to the existing "beneficial ownership/controlling persons" test under anti-money laundering laws which is widely adopted at the higher threshold of 25%. This has now been aligned under a Model IGA.

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Removal of superannuation products

During the consultation process, industry groups around the world lobbied for the removal of superannuation products from the definition of a "financial account". While it is seen as unlikely that these will be included as either exempt or excepted FFIs in the final regulations, there is a specific provision in the Model IGA that allows for the explicit removal of them from the scope of FATCA. Annex II of the Model IGA allows for other products to be explicitly excluded which will likely be subject to a reasonableness test.

Further commitments required by Model IGA governments

Governments of FATCA Partner countries will likely be required to introduce enabling legislation changes to domestic laws to allow the domestic tax authority and reporting FIs to comply with their obligations under FATCA. In addition, a Model IGA also imposes further commitments by governments in working alongside other OECD countries in developing a common model for automatic tax information exchange.

Enforcement process where obligations are not being met

Under the Model IGA, the onus is placed on the competent authority in the FATCA Partner country to action FATCA compliance failings raised to it by the IRS and to take action to enforce compliance from the offending Reporting FIs in accordance with local laws and powers. If after 18 months, the Reporting FI has not addressed compliance failings in line with the requirements imposed by the competent authority, then they must again be reported to the IRS that will classify the Reporting FI as a Non-Participating FFI (NPFFI).

With this process in place, it is unclear whether the proposed "certification" process for the FATCA Reporting Officers within a PFFI to attest to compliance to the IRS is still required, although most likely it will be replaced with a similar localised attestation process.

Overview of the FATCA requirements under a Model IGA

Treatment of offshore branches and subsidiaries

The Model IGA covers all "financial institutions"[2] that are resident in the FATCA Partner, including all onshore branches but does not, however, cover offshore branches or subsidiaries of these financial institutions.

This means that offshore branches that reside in countries that have not or are unlikely to enter into a FATCA Partner agreement with the US are unable to rely on the fact that the parent company resides in a FATCA Partner country. The implications of this will be felt by many domestic institutions that operate branches in remote parts of the world, that may not be aware yet what FATCA means to them.

There are no specific provisions under a Model IGA to permit financial institutions that reside in a FATCA Partner country to "opt out" as they could have done under the proposed regulations.

Instead, all financial institutions will become Reporting FIs[3] and only in the event of significant and continued non-compliance, shall a Reporting FI will be treated as a Non-Participating FI, which has a similar meaning to that of a NPFFI under the proposed regulations. The IRS has indicated that it will maintain a register of Non-Participating FIs.

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Simplified customer due diligence standards

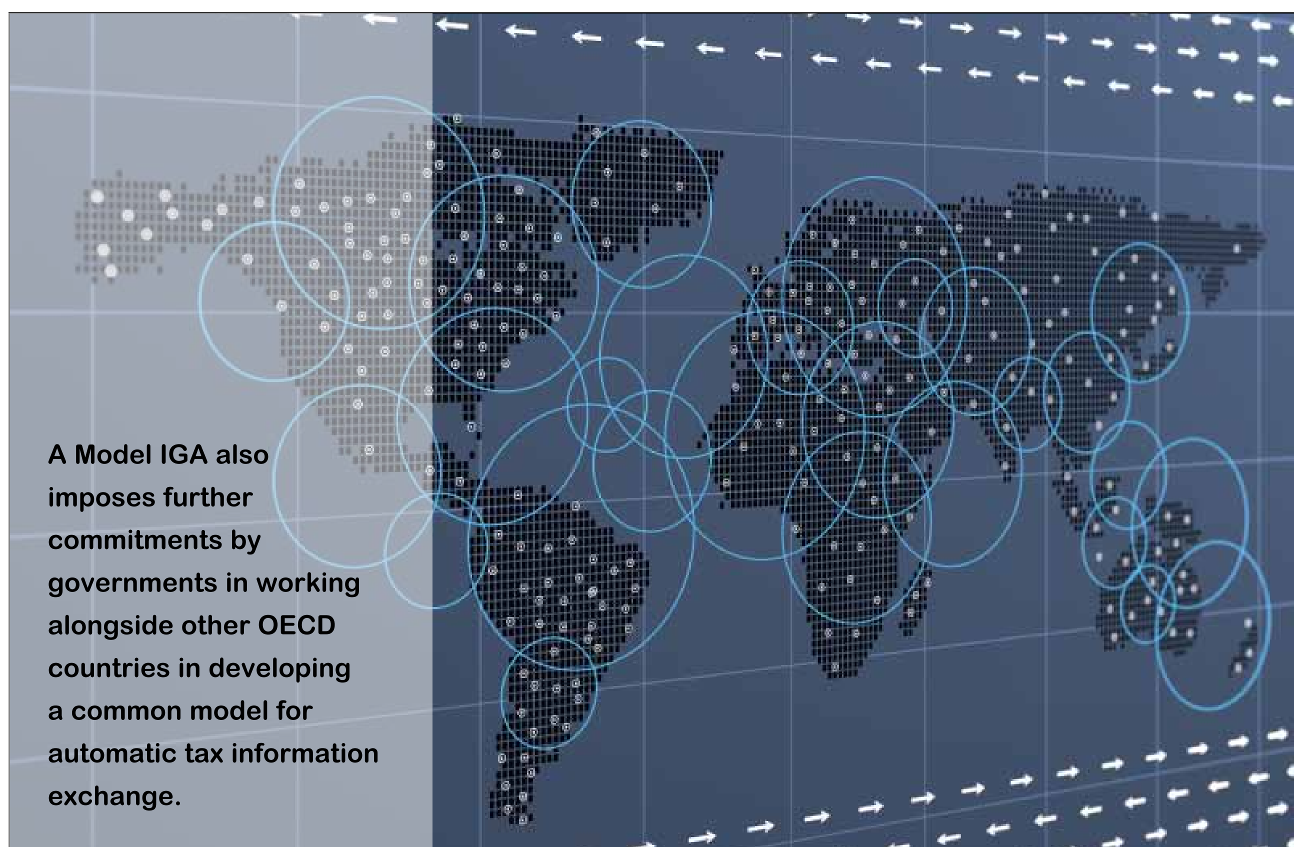
Under the Model IGA, each Reporting FI must identify US Reportable Accounts and accounts held by Non-Participating FIs. The concept of "recalcitrant" account holders, meaning those accounts that contained US indicia, but remain undocumented, appears not to be relevant in this context.

Annex 1 of the Model IGA outlines simplified procedures that Reporting FIs can use to conduct customer due diligence as an alternative to the procedures set out in the proposed regulations, although they are generally similar albeit with a few noteworthy concessions.

When Reporting FIs open new entity accounts after 1 January 2014 it is permitted to firstly rely on publicly available information or information held by the Reporting FI as a means of establishing the entity's FATCA status and then proceeding to accept a "self-certification" from the entity of the FATCA status. The Model IGA does not, however, reveal detail on the acceptable methods of self-certification and what would be required as a "reasonableness" test allowing Reporting FIs to rely on this information.

Further clarity is being sought on these points but it appears that self-certification could be achieved in as simple a method as the outright asking of the question "Are you a US citizen or resident for tax purposes?", or could mean collection of a withholding certificate (e.g. W-8BEN or W-9) or equivalent alternative documentation signed under penalties of perjury by the account holder. If the former satisfies the requirement, further consideration will need to be given as to how or whether to attempt to "future proof" changes against copycat regimes[4] that may or may not come to fruition until many years from now.

The Model IGA and the proposed regulations both allow for the certain accounts that fall below de minimis thresholds to be treated as non-US accounts and proposed the introduction of a "Currency Translation Rule" meaning that the currency conversion rate to the US$50,000 equivalent must be based on a published spot rate taken at year-end, which could potentially mean increases or reductions in those accounts subject to further review



A Model IGA also imposes further commitments by governments in working alongside other OECD countries in developing a common model for automatic tax information exchange.

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depending on the annual exchange rate fluctuation, and has some practical concerns which will need to be addressed.

Pre-existing account remediation

The method and thresholds for conducting pre-existing account remediation on accounts remains unchanged, but the date for when the data needs to be taken has been pushed out one year under a Model IGA to 31 December 2013.

Commencement date of FATCA under a Model IGA

The Model IGA once signed will take effect from either 1 January 2013 or the date the government of the FATCA Partner country notifies the US Treasury Department that the entry conditions for signing the Model IGA have been met, whichever is later.

The commencement date for implementing FATCA compliant customer due diligence procedures starts from 1 January 2014, which represents a six-month extension from the start date, where no Model IGA exists.

Summary of the main concessions afforded to Reporting FIs in Model IGA countries

There are a number of benefits that Reporting FIs that operate in an IGA country in addition to the simplified customer due diligence and an extension of the commencement date, however the most significant is immunity from having to withhold or being withheld against.

Under the Model IGA, each Reporting FI in a FATCA Partner country will not be subject to withholding under s 1471 of the US IRS code as long as the FATCA Partner complies with tax information exchange requirements and the Reporting FI fulfills obligations in respect of registration, identification and reporting of US Reportable Accounts to the domestic tax authority.

In addition, Reporting FIs who make payments or act as an intermediary with respect to a US-sourced withholdable payment to any Non-Participating FI, must provide any immediate payer information required for withholding and reporting to occur, and it does appear that withholding on payments is not generally required.

The Model IGA goes further to explain that Reporting FIs are not required to withhold on or close accounts of recalcitrant account holders, as long as the required information is reported to the domestic tax authority, that will in turn pass it onto the IRS.

Another concession included in the Model IGA is the ability for each country to define Exempt Beneficial Owners (EBOs) and specific products that fall outside the definition of a "financial account" in Annex II, so industry must act fast to define and explain the list of products that should be considered for this exemption[5].

Summary

While the Model IGA announcement is widely viewed as a positive step and will undoubtedly reduce the compliance overhead on Reporting FIs, there is clearly a long way to go before a common international framework for reporting and a due diligence model for automatic exchange of information is finalised.

So what can you expect next?

Now that the Model IGA has been released, we can expect dialogue between industry and respective Treasury Departments to increase significantly as further considerations are tabled before the final regulations are released, which is anticipated to be October or November 2012.

The focus will likely turn to domestic governments to quickly introduce enabling legislation required to allow Reporting FIs to rely on the Model IGA, such that certainty can be provided and prevent Reporting FIs from having to plan a FATCA program that satisfies different requirements and timeframes simultaneously.

Finally, given the number of governments likely to be joining the queue of those that are seeking to become FATCA Partner countries, the race will be on to come out in front of the queue in signing the agreement and providing much needed certainty to a nervous financial services industry. ■

REFERENCES:

1. http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Intergovernmental-agreement-to-implement-FATCA
2. The definition of which has been updated to align with the FATF for AML/CTF.
3. With the exception of those that qualify as "Non-Reporting FIs" under the exempt or excepted FFI status.
4. There have been reports the UK, France and India are considering introducing similar legislation to FATCA.
5. It is not clear what level of justification will be required to demonstrate the reasonableness of exclusions in the IGA.