

FATCA : Proposed Regulations (121647-10)

Latest proposals issued by US tax administration. Introduces an alternative inter-governmental approach for some “participating” countries.

Background

Despite some concessions in the latest updated proposals, FATCA compliance remains a significant challenge.

The Foreign Account Taxation Act (FATCA) was enacted in 2010 by Congress as part of the Hiring Incentives to Restore Employment (HIRE) Act. FATCA requires Foreign Financial Institutions (FFIs) to provide the IRS with information about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest.

In order to avoid withholding under FATCA, a participating FFI will have to enter into an agreement with the IRS to:

- Identify U.S. accounts,
- Report certain information to the IRS regarding U.S. accounts, and
- Withhold a 30 percent tax on certain U.S. connected payments to non-participating FFIs and account holders who are unwilling to provide the required information.

Following enactment of the HIRE Act, a series of Notices were issued providing preliminary guidance as to how the HIRE provisions would be implemented. These Notices, however, generated as many questions as they answered and also gave rise to a great deal of feedback and concern from entities likely to be within scope.

On 8 February 2012, the Treasury Department and IRS released their proposed regulations providing guidance with respect to information reporting and withholding.

Additionally, the US Treasury also issued a statement jointly with the **UK, France, Italy, Spain and Germany** expressing a mutual intention to pursue a government-to-government framework for implementing FATCA.

Where are we now?

For the first time, it seems as though the FATCA legislation may be applied using two distinct mechanisms: (i) FATCA as originally envisaged i.e. FFIs reporting to the IRS on an entity by entity/group by group basis and (ii) an intergovernmental approach whereby FFIs report to their home tax authorities. The tax authorities would then take responsibility for providing information to the IRS.

An inter-governmental approach

To be clear, the statement does not contemplate an exemption from FATCA for any jurisdiction. It offers a framework for information sharing pursuant to existing bilateral income tax treaties and allows FFIs to report the necessary information to their respective governments rather than to the IRS. The joint statement is intended to serve as a template for the United States to work with other countries.

Benefits for FFIs in “Participating” Countries

- FFIs in the “Participating” countries would automatically become Participating FFIs (PFFIs) and be granted FFI EIN numbers without having to enter into a contract with the IRS unless they fall under the expanded Deemed Compliant categories
- There would be no 30% withholding against firms in these Participating countries on their US sourced income provided they comply with the reporting requirements for PFFIs or deemed-compliant FFIs. Taxation of payments made in favour of Non Participating FFIs established in Non-Partner countries is still under discussion.
- Inter-governmental data exchange will overcome some of the difficulties associated with data protection/ bank secrecy laws and may limit the need for firms to alter customer terms and conditions
- FFIs in these countries will not have to terminate the accounts of Recalcitrant customers instead they would simply report on these accounts

Client Due Diligence still very much required

FFIs in participating countries must still apply the necessary due diligence rules and identify pre-existing clients that qualify as US accounts. In addition, they will most likely still have to update their new client on-boarding processes to capture additional information required to report on US accounts going forward.

Summary of key changes in draft regulations

It would appear that the Treasury and IRS have been listening to the concerns of overseas governments, financial institutions, and trade bodies and have made a number of important changes in the draft regulations:

Pre-existing client identification (Individuals):

- \$50k lower threshold remains (except for Insurance contracts with a cash value, in this case a the lower threshold has been raised to \$250k)
- Threshold for high value accounts has been raised from \$500k to \$1M.
- Electronic search now required from \$50k to \$1M and a manual/paper search >\$1M
- FFIs no longer required to distinguish between private banking accounts and other accounts but new concept of Relationship Manager Test has been introduced
- US indicia expanded to include US telephone number

Pre-existing client Identification (Entities) :

- Greater reliance on AML/KYC due diligence but 10% US ownership threshold remains
- Lower threshold raised to \$250k invested
- Greater reliance on existing KYC/AML processes
- Above \$1M, PFFIs must obtain info regarding substantial US owners or a certification that the entity does not have substantial US owners

New client on-boarding

- Proposed due diligence rules rely more extensively on an FFI's existing customer intake procedures
- No significant modifications other than with respect to account holders identified as FFIs, passive investment entities or as having US indicia and/or >\$1M
- In practice this will most likely mean that existing processes will need to be updated to identify the above exceptions

Expanded Affiliated Group

- Introduction of a two year transition period to 1st Jan 2016 for all entities in a group to become participating FFIs or deemed-compliant FFIs
- During this period if an FFI affiliate in a jurisdiction that prohibits an FFI's compliance with FATCA requirements will not prevent other FFIs within the same affiliated group from becoming participating FFIs

Timing of "grandfathered" obligations

- Enhanced relief for withholding agents from applying the 30% penalty on any "withholdable" obligations outstanding on 1st January 2013 (as opposed to 18 March 2012 in the previous notices)

Expanded Deemed Compliant categories

- Expansion of category to include certain banks and investment funds conducting business with only local clients, low risk entities or participating FFIs
- Deemed Compliant FFIs no longer have to register with the IRS and are permitted to self-certify

Transitional Period for Reporting

- For Reporting in 2014 and 2015 (with respect to years 2013 & 2014) PFFIs are required to report only name, address, TIN, account number and account balance with respect to US accounts
- Reporting on income will be phased in beginning in 2016 (with respect to 2015 calendar year)
- Reporting on gross proceeds will begin in 2017 (with respect to 2016 calendar year)
- In addition, PFFIs may chose to report in the local currency the account is maintained in or alternatively in US dollars

Pass through payments delayed

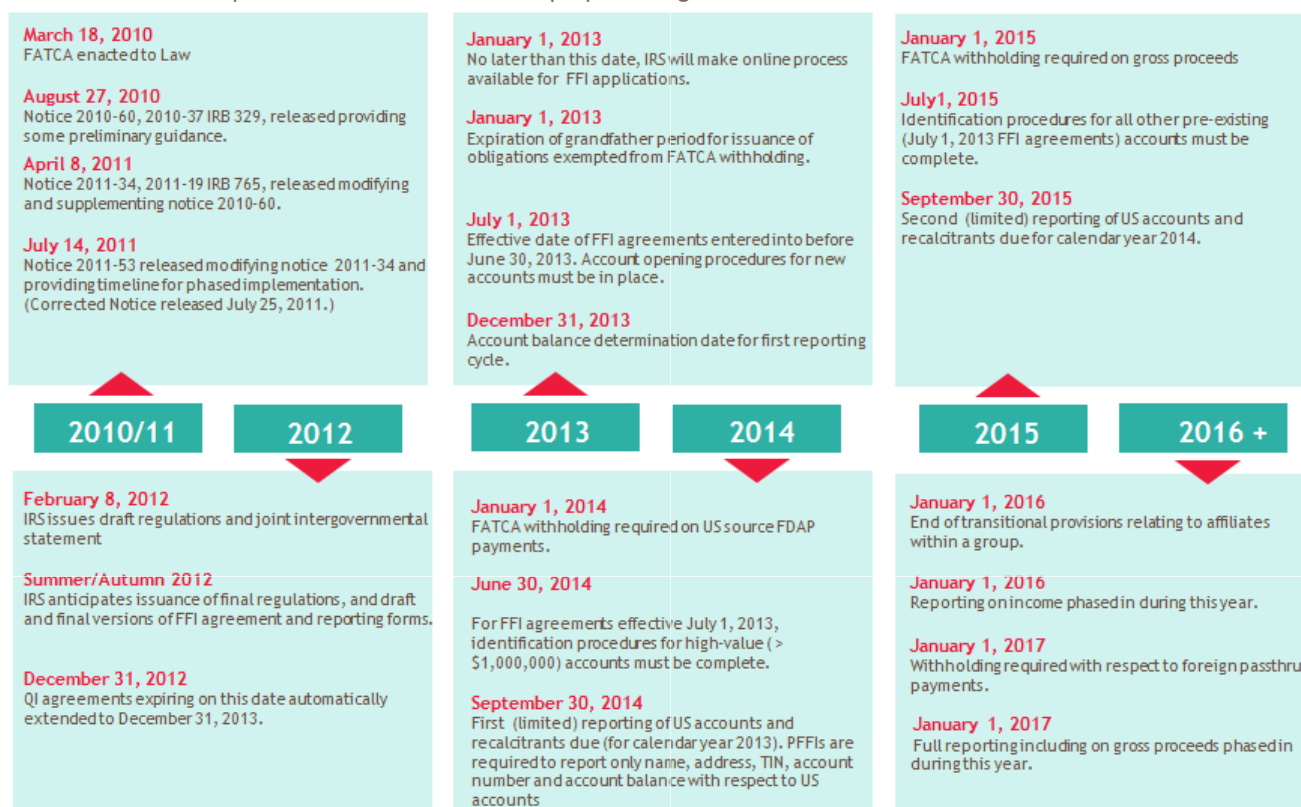
- Withholding on foreign pass-through payments comes into force now on January 1st 2017 (2 year delay)
- Until then the IRS will require PFFIS to report annually on the aggregate amount of certain payments made to each non-participating FFI
- So the threat of withholding on foreign pass-through payments remains although more time has been allowed to investigate practical means of implementation

Verifying compliance

- Unlike the Qualified Intermediary (QI) regime, PFFIs are not required at this stage to conduct an external audit to certify their compliance with FATCA. The Chief Compliance Officer (or equivalent reporting Officer) is however still expected to certify that the FFI has complied with the terms of the FFI agreement e.g. through internal reviews and attestations.
- Also FFIs that adhere to the requirements of the FFI agreement will not strictly be held liable in the event that they fail to identify a US account

Updated Timelines

An overview of the updated milestones under the proposed regulations is shown below:



What happens next with the regulations?

Governments, Financial Institutions, trade bodies and tax payers now have a further opportunity to comment on the draft rules and to seek further amendments to elements they believe remain challenging or costly to implement.

The US authorities have requested comments back on the draft regulations by 30 April 2012. A public hearing is scheduled for 15 May 2012 and organisations may request an opportunity to speak or provide outlines of topics for discussion by 1 May 2012.

The final regulations are expected to be written into law by the “fall” of 2012.

What should impacted firms be doing now?

Due to the complexities involved in meeting the FATCA requirements, firms will not have the luxury of being able to wait for the final regulations to be written into law before assessing the impact and starting to make the changes that will be required in their businesses.

Firms that have not already done so, need to appoint a suitably qualified and empowered Sponsor to assess the impact of the regulations and to set up the necessary internal Governance arrangements to oversee their compliance efforts.

Impact Assessment

The level of change required to comply with FATCA will be dependent on the nature and scale of your business together with the level of involvement with US customers. Each firm will have to conduct a detailed impact assessment into the extent to which FATCA requirements will affect their strategy, legal entities, products, services, processes, systems and their people. Some of the key elements of this impact assessment will include:

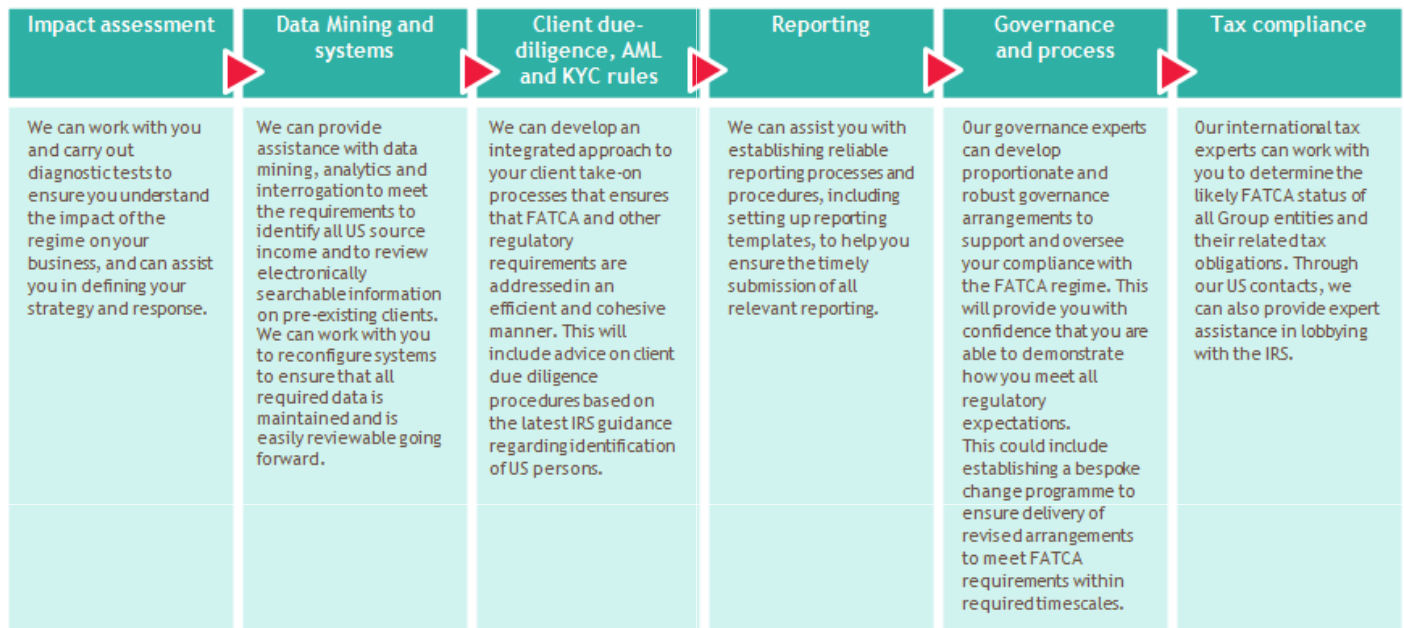
Entity classification - firms need to look across their legal entities to determine the likely classification for FATCA purposes e.g. Participating FFI, Deemed Compliant FFI, Non-Financial Foreign entity

Identifying Existing Clients - in order to establish presence of US indicia, firms face a complex data gathering/ data mining task in order to pull together relevant client information from across potentially multiple, unconnected systems or from paper files. The onus will be on the firm to disprove that they have US accounts.

Reviewing New Client On-boarding processes - FFIs will most likely need to amend their processes for account opening to take into account the new FATCA requirements. This will mean updating their current due diligence procedures for KYC (Know Your Customer) and AML (Anti-Money Laundering) in order to include FATCA requirements.

How BDO can Help

BDO can provide a comprehensive response that draws together the expertise of our multi-disciplinary team to deliver an integrated solution to all aspects of the FATCA regime. This will help you ensure that the taxation, regulatory, governance and technology aspects of compliance are each addressed in a cohesive manner.



As a starting point, BDO can assist you with your initial impact assessment on FATCA by running half-day or full-day workshops involving key stakeholders from within your Operations, Tax, Compliance, IT and Sales & Marketing areas.

Following on from these initial impact scoping workshops we can assist you in your detailed impact assessment by deploying online diagnostic tools to help you understand the scale of the task ahead and the strategic options that are available across your different business units.

For further information on how BDO can assist you in your FATCA compliance efforts, please contact:

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