

The Foreign Account Tax Compliance Act (“FATCA”) Update February 2013

This note sets forth the basic framework of FATCA and an update on the current state of international implementation. This note is for general informational purposes only and should not be relied upon as advice in any circumstances. US tax issues can be complex and require highly specialised advice giving careful consideration to a client’s particular circumstances.

Background

FATCA was enacted in 2010 as part of the Hiring Incentives to Restore Employment (the “**HIRE Act**”) with the aim of reducing tax evasion by US persons holding investments in offshore accounts. Draft FATCA regulations were released by the US Internal Revenue Service (the “**IRS**”) in mid-2012 and place potentially considerable burdens on foreign financial institutions (“**FFIs**”), including requiring FFIs to report financial accounts held by US taxpayers or in which US taxpayers hold a substantial ownership interest. Fortunately, the UK has signed a bilateral agreement with the United States (discussed below) that should largely ease many of the reporting and withholding requirements that would otherwise be imposed under FATCA. This bilateral agreement is the first of its kind, but it is anticipated that many other countries will enter into similar agreements with the United States. The final FATCA regulations were released on 17 January 2013 (the “**FATCA Regulations**”).

Summary

Under the FATCA regulations, an FFI will either be subject to certain withholding taxes under FATCA or it must enter into an agreement with the IRS (thereby becoming a “**participating FFI**”) to:

- identify U.S. accounts;
- report certain information to the IRS regarding its US accounts; and
- withhold a 30-percent tax on certain payments to non-participating FFIs and account holders who are unwilling to provide the required information.

FFIs that choose not to enter into an agreement with the IRS will be subject to withholding on certain types of payments, including US source interest and dividends, gross proceeds from the disposition of US securities, and passthru payments.

Foreign Financial Institutions

An FFI is defined as any non-US entity that:

- accepts deposits in the ordinary course of a banking or similar business;
- holds financial assets for the account of others as a substantial portion of its business; or
- is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.

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The definition of an FFI also includes banks, custodians, brokers, many types of funds and insurance companies but excludes governments or government held institutions. In addition, the provisions of FATCA may apply to both financial and non-financial operating companies. There is currently no *de minimis* threshold for investment vehicles and insurance companies.

Generally, the FATCA Regulations require FFIs to either enter into an agreement (an “**FFI Agreement**”) with the IRS or fall within the “deemed to comply” category in identifying their respective US account holders and report their financial activity annually to the IRS. By doing this, an FFI becomes a “participating FFI” and avoids withholding on payments it receives. Generally, an FFI Agreement requires a determination of which accounts are “United States accounts” and annual reporting on those United States accounts to the IRS. The FATCA Regulations also confirm the relevant dates for each stage of compliance with the legislation beginning in 2013.

International Response to FATCA and the Model Agreement

There was strong resistance from FFIs to the obligations FATCA would impose on such institutions for various reasons, including the concern that compliance with such obligations would not be possible under local laws. In particular, European FFIs would not be able to provide the required information without breaching data protection laws.

In order to address these and other concerns, in July of last year, the US Department of Treasury in consultation with France, Germany, Italy, Spain, and the United Kingdom developed a Model Intergovernmental Agreement for Implementing the Foreign Account Tax Compliance Act to Improve Offshore Tax Compliance and Reduce Burden (the “**Model Agreement**”). The Model Agreement provides for FFIs in the relevant jurisdiction to report information under local tax regimes and then for an automatic exchange of information between the relevant tax authority and the IRS.

The five countries that participated in the consultation and the United States, will work in close cooperation with other countries as well as the Organization for Economic Cooperation and Development, and, when necessary, the European Commission in order to establish common reporting and due diligence standards to effectively address tax evasion while mitigating compliance issues and burdens.

The US-UK Agreement

In September 2012, the United Kingdom and the United States entered into a Bilateral Agreement to Improve Tax Compliance, Combat Offshore Tax Evasion and Implement FATCA (the “**US-UK Agreement**”) based on the Model Agreement.

The US-UK Agreement was based on the Model Agreement and provides a framework within which:

- The legal issues with compliance in the UK, such as data protection issues are addressed;
- Withholding tax will not be imposed on income received by UK financial institutions;
- UK financial institutions will not be required to withhold tax on payments they make;
- The due diligence requirements are more closely aligned to the requirements under the existing anti-money laundering rules;
- There is a wider scope of institutions and products effectively exempt from the FATCA requirements; and
- HM Revenue & Customs will receive additional information from the US Internal Revenue Service to enhance its compliance activities.

HM Revenue & Customs conducted a consultation period on the implementing legislation for the US-UK Agreement from 18 September 2012 until 23 November 2012. The legislation implementing the US-UK Agreement in the UK will be included as part of the Finance Bill 2013 process. While the Finance Bill 2013 will likely not contain all of the specifics of the requirements for compliance with the US-UK Agreement, further legislation will be implemented in due course to address the detailed aspects of the US-UK Agreement.

Under the US-UK Agreement, only certain limited information will be required to be reported from 2013 for those entities required to do so under the terms of the implementing legislation. There will be additional reporting requirements for certain types of institutions in the coming years as additional phases of the legislation are implemented in the UK.

Information that must be reported from 2013 onwards includes the following:

- name, address, US TIN (i.e., Taxpayer Identification Number) or date of birth if there is no TIN;
- account number;
- name and identifying number of the reporting institution; and
- account balance or value.

In addition to the United Kingdom, the United States has also signed or initialled agreements with Italy, Norway, Mexico, Denmark, Ireland, Switzerland and Spain. The US Department of Treasury is also negotiating agreements with more than 50 other jurisdictions, which it hopes will be signed in the near future.

UK entities will now have to watch and wait while the relevant domestic legislation is enacted to implement the terms of the US-UK Agreement. Fortunately, wide-reaching US tax legislation that initially seemed overly burdensome and logistically and legally complicated should be made manageable for UK entities as a result of the US-UK Agreement.

If you have any questions or require US tax advice, please contact Daniel Winterfeldt (daniel.winterfeldt@cms-cmck.com) or another member of US securities team to discuss your queries or to obtain a referral for more specialist advice.