
Foreign Account Tax Compliance Act (FATCA)

Legal issues for non-US financial institutions

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What is FATCA?

The “Foreign Account Tax Compliance Act”

1. Brought into force March 18, 2010 by the HIRE Act
2. Purpose
 - prevent US taxpayers from using offshore accounts to evade tax (particularly relevant as US citizens are subject to tax on their worldwide income, regardless of residency)
 - impose obligations on US established financial institutions
 - also clearly extra-territorial : FATCA requires direct reporting by “Foreign Financial Institutions” (FFI) of information about US account holders by means of a “**voluntary**” contractual arrangement (FFI Agreement) with the IRS
 - **enforced** by 30% withholding tax on certain payments to non-compliant entities, e.g. if an FFI does not comply then US entities and participating FFIs will withhold 30% from certain payments to it.
3. Draft regulations issued by IRS on February 8, 2012
4. Final regulations and form of FFI Agreement are expected during Autumn 2012
5. Different timelines for compliance

Who is subject to FATCA outside the US?

“Foreign financial institutions” (FFIs). FFIs are non-US entities that:

- accept deposits in the ordinary course of a banking or similar business, or
- hold financial assets for the account of others as a substantial portion of their business, or
- are engaged primarily in the business of investing, reinvesting or trading in securities, partnership interests or commodities.
- Subject to a series of exceptions focused on de minimis activities.

Widely drawn. It includes banks, broker dealers, custodians, clearing organizations, insurance companies, trust companies, pension plans, hedge funds, private equity funds, exchange-traded funds and family investment vehicles.

Importantly, a financial institution might be an FFI even though it:

- Has no presence in the US;
- Holds no accounts of US citizens; and
- Does no business with US established legal entities.

How FATCA affects foreign financial institutions

FATCA imposes a significant compliance burden on foreign financial institutions. Each FFI must:

1. Enter into an FFI agreement with the IRS.
2. Identify a responsible officer to certify compliance
3. Carry out due diligence on account holders in order to identify US accounts or those with “US indicia”
4. Report identified US accounts to the IRS
5. Withhold on payments to FFIs who are not participating in respect of FATCA
6. Withhold on payments to account holders with US indicia who do not provide information (“recalcitrant”)
7. Close accounts of long term recalcitrant account holders

Key legal issues for foreign financial institutions requested to comply with FATCA

1. Conflict of laws : US imposed obligation vs. non-US counter-obligations
2. Key feature is that FATCA obligations are imposed on FFIs indirectly – by means of:
 - (i) contractual agreements with the IRS (the FFI Agreement) ; or
 - (ii) commercial actions of peers (withholding on non-participating or non-compliant institutions).
3. FFIs may not be able to comply with certain aspects of FATCA due to domestic legal impediments; areas of conflict between FATCA compliance obligations and obligations imposed by non-US laws include:
 - Banking secrecy
 - Personal data privacy / protection
 - Constitutional rights to privacy / human rights regimes
 - Consumer protection and non-discrimination legislation
 - Universal banking service obligations
 - Anti-withholding regimes (such as the payment services directive)
 - Limits on varying contractual terms
4. Impact on existing contractual terms: client / market facing documentation.

Solutions to FATCA legal issues for non-US entities

Jurisdictional issues:

1. For some jurisdictions : implement FFI agreement as required.
2. For other jurisdictions : implementation of FFI requires changes to national law or government level initiatives:
 - Draft inter-governmental agreements (IGAs) published by governments of US, UK, Germany, Italy, France and Spain. Requires two way exchange of information between non-US and US tax authorities.
 - Alternative inter-governmental agreement approach endorsed by Switzerland and Japan involving just one-way data sharing with the US tax authorities.
3. Practical requirements for financial institutions stem from the proposed Regulations and require due diligence on client base, reporting, notification to clients, seeking consents and identification of legal impediments to compliance.

Contractual issues:

1. Grandfathering: exemptions from FATCA
2. Amendment of terms
3. Industry initiatives, eg ISDA Protocol

Risks/timeline pressures

1. Sanctions for non-compliance with FATCA are financially material for FFIs.
2. Much of the detail necessary to understand FATCA's requirements for FFIs is either in draft (the regulations) or not yet released (the FFI Agreement and the national laws implementing the IGAs).
3. Number and scope of IGAs is not yet clear.
4. IT and process challenges to implement FATCA are significant, often with long lead times.
5. Volume of agreements to be reviewed and amended is potentially very significant.
6. Task of entering into FFI Agreements for all the FFIs in a group of companies could be very demanding.
7. Deadlines for compliance are fast approaching.