

FATCA IN A NUTSHELL

Tax evasion through the use of offshore bank accounts reinforces the need to foster cross-border administrative assistance on information exchange. Owing to its international dimension, states and some international organisations have devised a number of international regulations and mechanisms intended at fighting tax evasion. Alongside the efforts at international level, the United States (US) promulgated the Foreign Account Tax Compliance Act (FATCA) in 2010.

The legal basis for the application of FATCA is intergovernmental agreements (IGAs) between the US and other countries. The US has entered into agreements with a number of states. Two main models exist for IGAs. The most notable differences between the IGAs Model 1 and the IGAs Model 2 are the principle of reciprocity on information exchange and the way how the account details will be reported to the Internal Revenue Service (IRS). For instance, Turkey has reached an agreement in substance on Model 1 as of June 30, 2014. According to the IGAs Model 1, the contracting parties agree to exchange information on a reciprocal basis, and foreign financial institutions (FFIs) are required to report the information to local authorities rather than directly to the IRS.

Despite the existence of some differences between the IGAs Model 1 and 2, the essence of FATCA concerns imposing withholding and reporting requirements on US persons and certain foreign entities. The implementation of FATCA will result in a highly complicated international regime. Bearing in mind that those falling within the ambit of FATCA may face penalties, the personal and material scope of this US domestic law must be known.

FATCA requires US individual taxpayers to report information about their foreign financial accounts and offshore assets meeting the criteria laid down in the law. FATCA also imposes certain obligations on the US and foreign entities, such as US

withholding agents, US multinational companies and foreign financial institutions. The FATCA rules envisage strict requirements especially for FFIs.

An FFI is defined very broadly. It encompasses, but not limited to, an entity:

- accepting deposits in the ordinary course of a banking or similar business (depository institutions, such as banks),
- holding financial assets for the account of others as a substantial portion of its business (custodial institutions, such as mutual funds),
- engaging in the business of investing, reinvesting, and trading in securities, partnership interests, commodities, derivatives, and other passive financial assets (investment entities, such as hedge funds and private equity funds),
- Having cash value products or annuities, as is the case with certain types of insurance companies.

The obligations of FFIs vary depending on whether they enter into an agreement with the IRS. An FFI having an FFI Agreement with the IRS is referred to as a Participating FFI (PFFI), and the rest are referred to as Non-Participating FFIs (NPFFI). FATCA includes a number of obligations for PFFIs.

First, PFFIs are under an obligation to disclose foreign account details of US persons to the IRS. According to the Chapter IV of Subtitle A of the Internal Revenue Code, PFFIs must report –particularly- the following information on an annual basis:

- The name, address, and Taxpayer Identification Number (TIN) of each account holder which is a specified US person and, in the case of any account holder which is a US owned foreign entity, the name, address, and TIN of each substantial US owner of such entity,
- The account number,
- The account balance or value at year end, and
- Except to the extent provided by the Secretary, the gross receipts and gross withdrawals or payments from the account (determined for such period and in such manner as the Secretary may provide).

Second, the aforementioned law imposes on PFFIs a withholding obligation. A PFFI is to withhold 30 percent of any passthru payment to a recalcitrant account holder or to Non-Participating FFIs. A passthru payment is any withholdable payment or other payment to the extent attributable to a withholdable payment. A recalcitrant account holder is any account holder that fails to provide the information required determining whether the account is a US account, or the information required to be reported by the FFI, or that fails to provide a waiver of a foreign law that would prevent reporting.

The strict withholding obligation is likely to push FFIs in entering into agreements with the IRS. In fact, acknowledging that the US is a leading financial centre, FFIs would have no real chance in standing against entering into agreements with the US Treasury for the purpose of implementing and enforcing FATCA. For example, it is inevitable for Non-Participating FFIs to interact with PFFIs. Hence, FFIs- in spite of the theoretical possibility to not enter into agreements with the IRS- must be prepared for FATCA obligations. This makes the third requirement laid down with respect to PFFIs more vital.

PFFIs are bound to comply with verification and due diligence procedures set forth by pertinent US authorities. PFFIs must develop internal compliance programmes based on an impact assessment with a view to the nature, type and other specificities of the organisation. Specific committees or mechanisms must be established for the purpose of implementing the compliance programme. Overall, the necessary steps must be taken into consideration of the requirements of the IGA in question.

That being said, getting prepared for FATCA requirements does not seem simple. The international enforcement regime that FATCA aims to construct will be based on an interaction between multiple regulatory regimes. The concurrent application of US regulations and national legislations will cause certain conflicts of law. It may not be always easy to harmonise the jurisdictional differences. For instance, different schemas in multiple jurisdictions as to data management and transmission may end up with –in some cases- a violation of secrecy laws of the

cooperating states. FFIs thus must be aware of and get ready for upcoming challenges of such kind.

As LBF Partners, we offer high quality legal service to financial institutions for their FATCA compliance programmes. Our service includes a tailor-made impact assessment, due diligence guidance, and training. We also offer a first class consultancy on jurisdictional conflicts stemming from the FATCA process.