

Implementation Challenges From the Evolving IGA Regime

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Purpose of IGAs

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- The immediate aim of an IGA is to enable “local” FFIs to overcome potential local law impediments to comply with the U.S. FATCA regime:
 - ▣ Privacy and data protection issues
 - ▣ Requirement to withhold tax for a foreign tax authority (i.e., the U.S. IRS)
 - ▣ Obligation to close – or refuse to open – certain accounts
- However, the regime is steadily morphing into a multi-national system where financial institutions may have to provide information on customers to many countries, not just the U.S.

IGA Adoption To Date

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- There are two different IGA Models:
 - ▣ Model 1 – the local FFI reports to its local tax authority which then exchanges that information with the IRS.
 - There is a reciprocal and a non-reciprocal version.
 - ▣ Model 2 – the local FFI is allowed to report directly to the IRS.
- The only signed IGA is with the U.K. and it needs implementing legislation to be effective.
- The U.S. Treasury has confirmed that over 50 countries are currently negotiating or discussing IGAs.
 - ▣ Treasury/IRS takes the position that an IGA is an executive agreement and not a treaty requiring the advice and consent of the Senate.
 - ▣ Treaty and non-treaty countries apparently may enter into IGA agreements.

OVERVIEW OF THE IGA

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- Basic Structure
 - 10 Substantive Articles
 - Annex I – a liberalized version of the due diligence and documentation requirements in the FATCA proposed regulations.
 - Note: It may be that these liberalized standards are foreshadowing the rules in the final FATCA regulations.
 - Annex II – a list of U.K. specific items:
 - Exempt Beneficial Owners
 - Deemed-Compliant Financial Institutions
 - Exempt Products

Articles 2 & 3: Exchange of Information (From U.K. IGA)

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- The amount and characterization of payments is determined under local country tax law – not U.S.
- 2013 and 2014 Local FI reporting Obligation:
 - ▣ Name, address and U.S. TIN of direct account holder
 - ▣ Account Number
 - ▣ Name/ID Number of Reporting Local FI
 - ▣ Account Balance/Value (end of year or other “appropriate period”)
 - ▣ Same for owners of non-U.S. entities plus name, address and U.S. TIN (if any) of the entity itself.

Articles 2 & 3: Exchange of Information (Cont'd)

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- 2015 Local FI Obligation:
 - ▣ Everything that one must do in 2013 and 2014; PLUS,
 - ▣ The gross income paid to a custodial or depository account (but not gross proceeds); and
 - ▣ The gross amount paid to the account with respect to which the U.K. FI is the obligor or debtor, including the aggregate amount of redemption payments.
- 2016 Local FI Obligation:
 - ▣ Everything above PLUS
 - ▣ Gross proceeds paid to custodial accounts.

Articles 2 & 3: Exchange of Information (Cont'd)

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- USFI Reporting Obligation Starts For 2013:
 - ▣ Name, address, birthdate of “account holder” (apparently not indirect owners of entities);
 - ▣ Account number;
 - ▣ Name and ID number of reporting USFI; and,
 - ▣ Gross amount of income (NOT proceeds) paid to the account provided it is currently reportable under Chapters 3 and 61.
- Timing of Governmental Exchange
 - ▣ No later than Sept. 30
 - For 2013 and 2014, HMRC will provide information by September 30, 2015.
 - ▣ U.K. proposed deadline for its FIs is March 31, with staggered reporting in 2015 for data with respect to 2013 and 2014

Annex 1

- Provides detailed due diligence and documentation requirements based largely on those in the proposed FATCA regulations:
 - Many requirements refined and/or liberalized from the proposed regulations:
 - Use of account and public data; and,
 - Use of “self-certifications” instead of Forms W-8.
 - Treatment of NPFIs and aggregate reporting; and
 - Introduction of special definitions – particularly “Active NFFEs.”

Annex 2

- Provides specificity regarding IGA Partner exempt beneficial owners, deemed-compliant FFIs, and exempt products.
- Open Issues
 - ▣ Establishing the status of Annex 2 entities.
 - ▣ Registration requirements?
 - ▣ Addition of other items in the future?

Potential Effect of Reciprocity on USFIs

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- The U.S. has committed to achieving “reciprocity” with FATCA partners.
- Does this mean that USFI domestic U.S. systems and procedures will need to be substantially modified if USFIs must collect and report on the same information as a Partner FI? For example:
 - Looking through entities to identify any Partner tax resident owner.
 - Reporting account values/balances.
 - Reporting all payments to an account/counterparty.

Self-Certifications in IGA Jurisdictions

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- What kind of self-certification is contemplated by the IGAs?
 - ▣ A standard format agreed to by the U.S. and IGA countries?
 - ▣ Something that each IGA FI can develop on its own?
 - ▣ Considering the continuing relevance of regulatory FATCA types (e.g., deemed-compliant FFIs) even within an IGA jurisdiction, is there anything to be gained from using something other than the Form W-8 which already asks for information on each type of FATCA entity?

Annex 2 Documentation Challenges

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- Do USFIs and FFIs have to develop systems and procedures to identify and verify that an IGA Partner country entity is in Annex 2 for that country?
- For example, what does a USFI have to do if a Spanish customer says that it is exempt under Annex 2 of that country's IGA with the U.S.?
 - ▣ Will there be a unique ID number? Which country's?
 - ▣ Rely solely on self-certification or Form W-8?
 - ▣ Cross check any certification with the Spanish Annex 2 list?

IGA Legal Construction Issues

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- When must an FI in an IGA country look to local law to fill in a missing detail (and there are many) and when must it look to the FATCA regulations?
 - ▣ U.S. Treasury officials have suggested both approaches depending upon the particular issue.
 - ▣ For example, look to regulations for grandfathering or deemed-compliant definitions but to local law for AML/KYC type rules.
- Note: The more one looks to local law, the more variation each jurisdiction potentially will have with respect to its requirements.

Moving Target?

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- The IGA leaves open the possibility that all partner jurisdictions will re-negotiate key concepts such as due diligence, documentation and reporting by 2017.
 - What is the potential that USFI and FFIs will build systems to meet the requirements of the FATCA regulations and IGAs only to see them change a few years down the road?
 - Given this uncertainty, can FIs make system modifications now to try to anticipate these changes (e.g., building in flexibility with data bases and data collection systems to add new requirements)?

Documentation Collection Standards

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- It is suggested that Partner FIs should look to local law to determine what kinds of documentation and validation standards should be followed.
- The following could differ from jurisdiction to jurisdiction.
 - Relying on faxes, copies and electronic documents.
 - Relying on documents received from affiliates or other FIs, regardless of current IRS limitations.
 - The kinds of acceptable identification documents.

Constructing a Multi-national Solution

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- How can a multinational FI build systems to accommodate IGA and non-IGA jurisdictions and USFI standards (i.e., the latter two both governed by the FATCA regulations)?
 - Can one system be built based on elements common to the IGAs and the regulations?
 - Will there have to be a jurisdiction-by-jurisdiction approach to accommodate both Annex 2 but also local law interpretations that differ among jurisdictions?

Multinational Compliance

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- How should a multinational FI set up a compliance structure to deal with IGA and non-IGA jurisdictions?
 - Should there be one global “owner” for FATCA compliance or should responsibility be more localized?
 - How would audits of FATCA obligations be handled in different jurisdictions – through local efforts only or somehow centralized?
 - Should a “responsible officer” approach be used in IGA jurisdictions as required by the FATCA regulations?

Potential Effect of IGAs on Chapter 3 Compliance

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- Tax officials in some IGA countries appear to believe that FATCA withholding can only apply to amounts deemed U.S. source under their rules – that is, capable of being withheld by a U.S. custodian and not by a local FI that may be prohibited from withholding for the IRS.
 - ▣ How does this square with the FI's obligation to withhold Chapter 3 amounts where necessary on securities lending transactions, repos, and specified notional principal contracts (“dividend equivalent amounts”)?
 - ▣ How about the effect on the re-sourcing rule for deposit interest of USFIs with branches in an IGA country?

Potential Effect of IGAs on Chapter 3 Compliance (Cont'd)

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- If local FIs are prohibited under local law from withholding for the IRS on U.S. source amounts then:
 - How can a QI ever be a withholding QI in such a jurisdiction? (Note: this situation appears to exist in such jurisdictions.)
 - What is the effect on the qualified securities lender (“QSL”) regime that is designed to ensure better compliance by FFIs with their obligations to withhold on dividend equivalent amounts?

USFIs Operating in IGA Jurisdictions: Chapter 61 Effects

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- The non-U.S. branches and affiliates must comply with existing domestic backup withholding and Form 1099 rules even though they are located outside the United States.
 - For example, the German branch of a U.S. bank must identify U.S. tax residents and comply with any backup withholding and Form 1099 reporting obligations.
- It is unclear how IGAs affect these obligations.

USFIs Operating in IGA Jurisdictions: Chapter 61 Effects (Cont'd)

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- Must non-U.S. branches and affiliates of USFIs report U.S. owner information to the FATCA Partner (if it is a Model 1 jurisdiction) and Forms 1099 to the IRS?
 - ▣ Much of this information will be redundant.
- In a Model 2 jurisdiction, could Form 1099 reporting take the place of any FATCA required reporting since both go to the IRS?

Open Administrative Issues

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- With whom will Annex 2 entities and any “deemed-compliant” FFIs register?
 - ▣ The IRS? Local Authorities?
 - ▣ Will one of these authorities issue identification numbers and maintain a database that will need to be cross-checked by FIs seeking to validate Annex 2 entities?
- How will the presence of IGA affiliates and branches affect the FFI agreement with the IRS for a global FI?
 - ▣ Are they all to be listed in a consolidated FFI Agreement even though they technically are not a part of an FFI Agreement with the IRS?

Defining FIs

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- A central requirement for USFIs and FFIs is to determine whether they are dealing with an FFI or an NFFE since different documentation and validation requirements apply to each.
- However, the FATCA regulations and the IGAs use different FI definitions, most notably the introduction of “investment entity” in the IGAs in place of category 3 FFIs in the regulations.
 - Does this mean that a multi-jurisdictional entity could be treated differently in each place?
 - How can standardized systems be developed if this remains the case?

Definition of “Investment Entity”

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- Background: The IGAs eliminate the Category 3 FFI definition of the proposed regulations in favor of a new concept whereby an entity is an FFI if it:
 - Conducts as a business for or on behalf of a customer:
 - Trading in money market instruments, foreign exchange, interest rate and index instruments, transferable securities or commodity futures trading;
 - Individual or collective portfolio management; or
 - Otherwise investing, administering or managing funds or money on behalf of other persons.
 - OR is managed by an entity that conducts the above as a business.
 - The IGA’s “investment entity” definition must be interpreted consistently with the FATF definition of “financial institution” which has led to substantial confusion as to which entities are covered.

Investment Entities (Cont'd)

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- **The IGA's new definition of "investment entity" has the following effects:**
 - **Management type entities**, such as investment advisers or portfolio managers, are drawn into FFI status (e.g., an investment manager overseeing a closely-held family investment company) – and have FATCA reporting and withholding responsibilities.
 - **Small investment entities**, like a family trust that is not professionally managed, is treated as a passive NFFE and not an FFI – and would have to provide ownership certifications to the relevant withholding agent.
 - **But such an entity IS an FFI if it is professionally managed**, so both the manager and "managee" are FFIs with separate reporting responsibilities.

Investment Entities (Cont'd)

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- Does the U.S. really intend to treat ownership interests in management-type entities as “financial accounts” subject to FATCA reporting?
 - For example, an investment adviser managing small investment companies is a partnership – are the partnership interests “financial accounts?”
- How does the government expect the manager and managee to sort out their respective FATCA withholding and reporting responsibilities?
 - Presumably the IGA contemplates contractual agreements between the parties to assign compliance to the manager – is this the intent?

Definition of Depository Institution

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- Likewise, the IGA definition of “depository institution” does not define what is a “banking or similar business,” unlike the proposed regulations:
 - Nor do the IGAs define the term “deposits” although they do define the term “depository account.”
 - Does one look to the definition of “depository account” to figure out what entities are covered? If yes, this is a much more restrictive approach than the proposed regs.
- Are credit card businesses FIs under the IGAs?
- How about factoring?
- How about leasing (capital or operating leases)?
- How about landlords accepting “deposits” from tenants?
- Should margin accounts be treated as “depository accounts”?

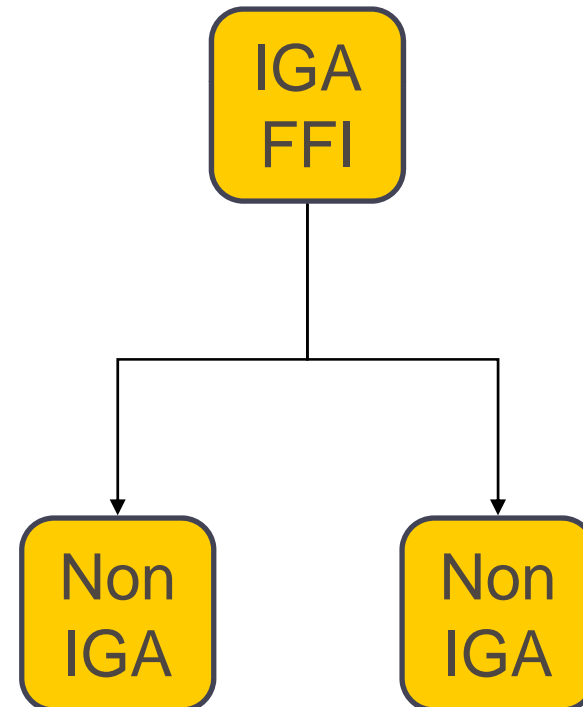
Definition of Custodial Accounts

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- The IGA definition of “custodial institution” turns on an FI holding “financial assets for the account of others.”
 - ▣ The IGA contains no definition of “financial asset” so does one look to the definition of “custodial account” for guidance?
 - ▣ If not, should fiduciaries accepting cash from parties to a commercial transaction be defined as “custodial”?
- Is it anticipated that the IGA partner will determine what is covered?
 - ▣ Will this lead to different jurisdictions treating the same type of entity differently depending upon local law?

Expanded Affiliated Group

- Under FATCA, all FFIs in EAG must be Participating FFIs.
 - Under IGA, FFI in an IGA country will not be prevented from becoming compliant as a result of being related to entities or branches that are Nonparticipating FFIs if such related entities/branches operate in jurisdictions that prevent them from becoming a Participating or a Deemed-Compliant FFI, provided certain procedures are followed.
 - However, that is not the case under the IRS Proposed Regulations, at least after 2016.
 - Thus, a Global FFI that has FFIs in non-IGA countries that are not compliant after 2016 due to local law conflicts will all become noncompliant, while FIs in IGA countries will remain compliant.
- IGA FFI will be compliant but non-IGA FFIs will not be under rule.



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