

FATCA

Foreign Account Tax Compliance Act

By Dana Ward and Anne Stopford



The clock is ticking and with FATCA rapidly approaching, there is potentially much work to be done to ensure compliance.

Background

A severe global recession, the resultant focus on the financial industry and low tax-take have had diverse and resounding impacts around the world. This is starkly apparent in the country where the housing-related contagion first originated – the United States (US) of America.

Barack Obama, as a fresh and new President, set out to pursue US tax evaders for the many billions of dollars suspected to be held within foreign jurisdictions. The political maelstrom demanded that those not paying their way were to be tracked down and held to account. The famously secretive Swiss banking industry was first in the IRS' sights with UBS being the initial target. UBS eventually settled out of court with the IRS for \$780 million and surrendered around 5,000 client names and details. It is now reported that there are other Swiss institutions and a Liechtenstein bank which are about to experience the same scrutiny and pressure. This, combined with an expanding network of double tax treaties and greater information sharing, means that the net is starting to tighten on US tax evasion.

One piece of legislation in particular is set to take US tax compliance and reporting beyond the US shores – the Foreign Account Tax Compliance Act (as part of the HIRE ACT 2010) more commonly known as FAT-

Glossary of Terms

Deemed compliant - some FFIs (see below) can potentially be deemed compliant if they meet certain requirements and can have their application approved by the IRS

Exempt FFIs - only in certain situations may exemptions be qualified for

FFI - Foreign Financial Institution - any entity that accepts deposits in any way similar to a bank, holds financial assets for others or is investing/trading in securities. These will be either participating ('Good') or non-participating ('Bad')

IRS - the US Internal Revenue Service

NFFE - Non Financial Foreign Entity - foreign entities that are not FFIs. If they are the beneficial owner of the relevant assets then this will have to be proven; in all other cases then the 30% withholding tax will be applied

Passthru payment - any withholdable payment or other payment to the extent attributable to a withholdable payment

QI - Qualifying Intermediary - those financial institutions who already have an agreement in place with the IRS regarding correct withholding on behalf of their underlying clients

Recalcitrant - those account holders who have not been sufficiently and rigorously documented. These are therefore liable to the punitive 30% withholding tax rate

TIN - A Taxpayer Identification Number (TIN) is an identification number used by the Internal Revenue Service (IRS) in the administration of tax laws. It is issued either by the Social Security Administration (SSA) or by the IRS. A Social Security number (SSN) is issued by the SSA whereas all other TINs are issued by the IRS. A TIN must be furnished on returns, statements, and other tax related documents.

US accounts - a depository or custodial account, equity or debt interest in an FFI owned by a US individual (under citizenship, green card or substantial presence test); company (as decided by place of incorporation); partnership (law of formation) or trust (prevailing court of law)

US persons - any US individual, body corporate, trust, partnership

CA. The act will increase compliance and transparency around US persons and assets whilst harshly punishing those that do not fulfil the requirements. The ramifications for institutions around the world are serious and real, and they should be planning now how FATCA requirements are to be incorporated into the future operations of their businesses.

What is FATCA?

FATCA is the legislation written in order to specifically address the avoidance of tax by US persons through foreign financial institutions. The purpose of FATCA is, therefore, to ensure that the IRS can identify and collect the appropriate tax from US persons holding financial assets outside the US. FATCA legislation potentially applies to any company or entity with US clients or assets that could generate US source income.

FATCA shifts the onus of tax reporting and compliance onto any company holding or trading US assets on behalf of others.

Compliance will be sought through rigorous client identification processes and those deemed not to be compliant will suffer 30% withholding tax.

So why should non-US institutions have any interest in US tax compliance and reporting?

It could be easy for some non-US institutions to believe that they will not be affected by FATCA as they do not have any US investors. However, this legislation is structured such that all accounts will be deemed to be non-compliant or 'recalcitrant' unless the institution has evidenced their undertaking of a rigorous due diligence process (as set out in various IRS guidance notices) to prove they have no US account holders. Otherwise, 30% withholding tax will be applied to every US source income or gross proceeds resulting from the disposal of US assets.

The purpose of FATCA is to ensure that the IRS can identify and collect the appropriate tax from US persons holding financial assets outside the US.

Who does the FATCA legislation affect?

Through the use of a new withholding tax, FATCA will affect every person or entity that has any interest in US assets – in either capital value or income arising from these assets. Although the major targets are US persons holding assets outside the US, the strict documentation and compliance procedures dictated by FATCA means that even those institutions with no US clients or investors will be seriously affected.

FATCA will place a significantly increased burden on any FFI and certain NFFEs who must identify, document and report on US accounts. FFIs will broadly include every member of the investment community and as currently drafted, will encompass banks (whether retail, wholesale, investment or private); custodians; asset managers; funds; brokers (where operating under matched principal) and insurance companies (where their products have an investment element).

What are the penalties for non-compliance?

As previously mentioned, non-compliance, or recalcitrance, will result in the FATCA 30% withholding tax. As a result, this poses a serious business risk to the institutions, as they themselves hold the responsibility for compliance. It is therefore likely that clients would expect them to assume the associated risk and underwrite any associated costs (where the underlying client could otherwise be compliant).

The withholding tax will be suffered on 'withholdable payments' which will include:

- interest, dividends and other periodic payments from US assets
- gross proceeds on the disposition of property of a type that can produce US source income
- deposit interest paid by US and foreign branches of US banks, even

though certain portions of this interest may not be treated as US source under current US tax law.

What needs to be disclosed?

When reporting to the IRS on US accounts, not only should the details of the holder be provided (eg name, address and TIN), account numbers and balances of each applicable account, details on the gross receipts and gross payments or withdrawals throughout the year will also be required.

What are the key issues?

The advent of FATCA will have an impact across various business areas of financial institutions and could influence long-term strategic objectives. Some of the impacts that are likely to be experienced by these institutions can be categorised as follows:

Business issues - businesses will need to consider how much they value the US as either a source of investment or clients. For most larger financial institutions, it will be impossible to withdraw from the US but for smaller or more boutique firms with limited exposure, complete withdrawal may be the most cost effective option. On the other hand, an ability to access US markets and investors could become a unique selling point of, for instance, some private client investment managers. As such, this is a real strategic decision rather than just an administrative matter. Businesses will also have to look very carefully at who holds the liability for the 30% withholding tax should it be suffered - where it would apply to gross proceeds then this could be a considerable cost or lead to the loss of clients.

“The advent of FATCA will have an impact across various business areas of financial institutions and could influence long-term strategic objectives.”

Operational issues – Any information held on each client will have to be up to date, complete and electronically available in order to comply with reporting requirements, which may mean a laborious process of data gathering. Those companies that do not have any US clients but do have direct or indirect US assets will need to be able to prove this to the IRS (in a rigorous but yet cost-effective way) to avoid having the irrecoverable 30% withholding tax applied. Their systems will also have to be reviewed and consideration given to whether automated controls should be put in place to prevent movements of US assets for recalcitrant account holders to avoid inadvertent withholding tax being suffered.

Compliance issues – FATCA will increase the level of US reporting to be undertaken at the end of every year by FFIs. There will be issues surrounding how this information will be maintained, gathered and reported and to what extent this may become automated. For those FFIs who are already QIs, it is hoped that the reporting for FATCA can be integrated into current requirements, but the IRS has yet to make it clear how this would work and the FFIs systems could require major adjustments to allow this.



Any information held on each client will have to be up to date, complete and electronically available in order to comply with reporting requirements, which may mean a laborious process of data gathering.



Legal issues - some entities may exist in countries with local restrictions on the disclosure of personal information to foreign governments or even banking secrecy laws. FATCA requires that these are waived by each client where necessary and then, if refused, the client should be disengaged with. However, there are also allowances to be considered. Such as, if a large number of small accounts (ie <\$50,000) are represented, the entity may qualify for an exemption or be deemed compliant.

How long before FATCA is enforced?

The effective date and withholding will commence 1 January 2014 for US dividends and interest. This will be extended to all withholdable payments, including gross proceeds and passthru payments, on 1 January 2015.

What are the key dates?

FATCA will require participating FFIs to enter into an agreement with the IRS and report directly to it certain information about financial accounts held by US taxpayers. FFIs should enter into an FFI Agreement by 30 June 2013 to ensure they are identified by US withholding agents as participating FFIs not subject to withholding as at 1 January 2014. At this time, the IRS has not specified expected timeframes

for processing FFI applications or released FFI application forms/supporting documentation requirements (an electronic application process is expected to be available early 2013). It would therefore be advisable for FFIs to submit their application as soon as they can to afford the IRS sufficient time to process the application.

Final regulations, FFI agreements and reporting forms are due to be released over the summer of 2012, although draft regulations and guidance is expected later this year. Any FFI that enters into an agreement will be considered to have renewed their QI agreement. Those QI agreements that expire at the end of 2012 will be automatically extended to the end of 2013.

FFIs should be carrying out proper due diligence process on existing and new clients through 2013, and will have to comply with the terms of their FFI agreement (certain processes will have timeframes set for completion). Any US accounts identified before 30 June 2014 will need to be reported (name, address, TIN, account number and balance) to the IRS by 30 September 2014. Any discrepancies identified by the IRS, which are not resolved, will then be treated as recalcitrant.

Following withholding on US interest and dividends commencing on 1 January 2014, a full withholding programme will be in place a year later from 1 January 2015.

Grant Thornton can help businesses meet their FATCA obligations by collaborating with them through any or all of the FATCA phases.

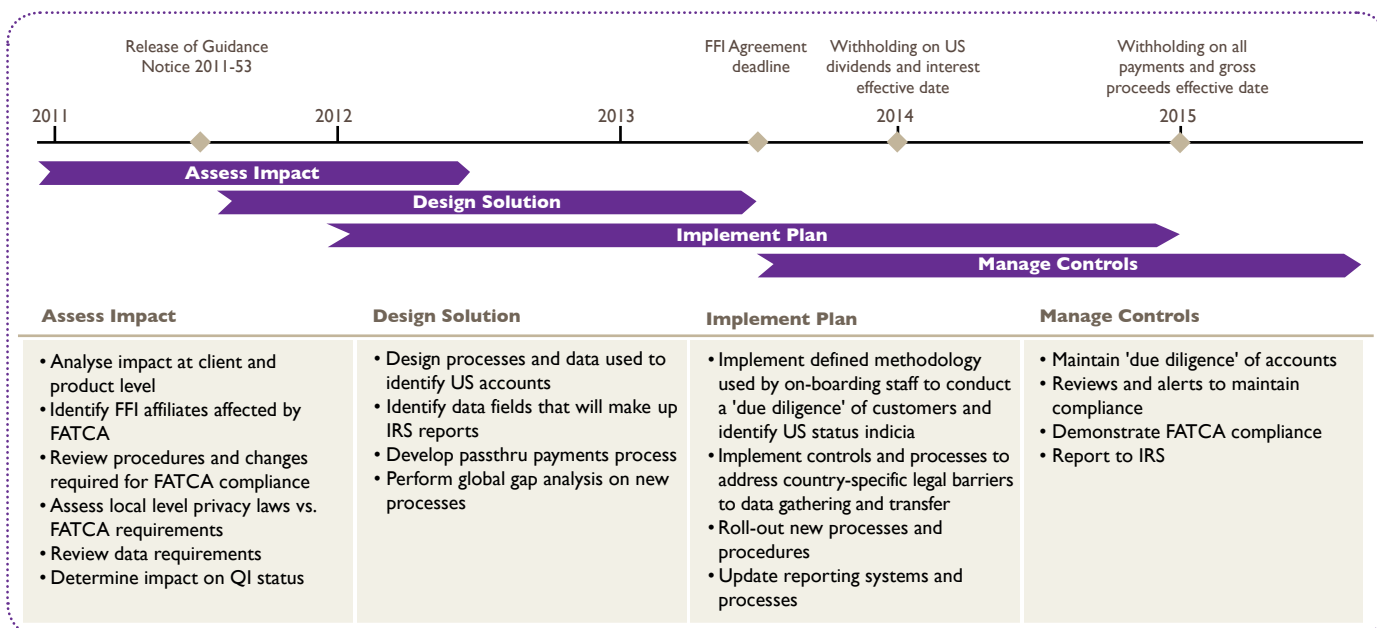
Why prepare now?

The effective date of 1 January 2013 was extended, but is still fast approaching and there is an increasing apprehension that the time to complete a FATCA implementation could take longer than the time remaining.

There are numerous strategic and operational decisions that need to be investigated which are likely to take a long time to implement. The deadline was relaxed by the IRS in response to industry warnings that, due to the amount of unknown variables and the extent of imposed changes, the industry would not be ready for FATCA by the old deadline.

The new deadline means that it should now be possible to get everything in order before then, but this should be treated as an opportunity to prioritise a FATCA implementation rather than a reason to relax. Businesses will need to have all the analysis, systems and controls in place prior to applying for an agreement, to ensure they get an agreement in place before the deadline. If no action is taken and deadlines are missed, the 30% withholding will start being applied.

A series of project phases must be undertaken to ensure an institution will be FATCA compliant. We would expect these to be carried out within the timeframes shown within the following diagram (above right). These timeframes and associated activities are by no means set in stone and are purely illustrative.



Why Grant Thornton?

The clock is ticking and with FATCA rapidly approaching, there is potentially much work to be done to ensure compliance. Grant Thornton works with a wide array of financial institutions, providing advice and implementation support and is well versed in the implications of FATCA and meeting the compliance requirements. Grant Thornton can help businesses meet their FATCA obligations by collaborating with them through any or all of the FATCA phases. Whilst Grant Thornton has a breadth of FATCA knowledge on both sides of the Atlantic, the UK team has also been involved in providing advice and audit services to participants of the QI regime, FATCA's predecessor.

To find out more about Grant Thornton's FATCA services, contact us on FATCA@uk.gt.com

FATCA Expertise	Our UK and US Tax teams are experts on FATCA relationships, they sit on industry committees, present at seminars and advise clients on the forthcoming impacts of this legislation. We already have deep expertise in providing QI services to clients and negotiating with IRS on their behalf
IRS Relationship	The US Tax team has good relationships with key IRS and Treasury personnel responsible for implementing FATCA. We can provide advice and direct representation to keep you aware of developments and offer direct involvement in that process
Global Reach	More than 2,500 partners provide clients with distinctive, high quality service in over 100 countries

About the authors



Dana Ward
Tax Partner, Head of Financial Services Tax UK
 T +44 (0)20 7728 3316
 E dana.ward@uk.gt.com

Dana joined Grant Thornton's financial services group after spending 17 years with two of the Big 4 firms. Dana has worked across all areas of QI regulations including, within an inter-dealer broker, health checks, audits, waivers, systems analysis and reform and staff training. She was also involved in negotiations with the IRS surrounding a phase 2 audit.

Dana has been a panel speaker on FATCA/QI issues at external and Grant Thornton organised conferences and seminars on the subject. Until the regular rotation, she was a member of the IMA tax committee discussion group on FATCA.

Outside of FATCA/QI assignments, Dana has extensive experience of cross border transactions and structuring. Dana works with many global financial institutions on a wide array of fund structuring and tax planning issues.



Anne Stopford
Tax Partner, Financial Services Tax UK
 T +44 (0)20 7865 2285
 E anne.stopford@uk.gt.com

Anne joined the financial services tax team at Grant Thornton following the firm's merger with RSM Robson Rhodes in July 2007 after spending 20 years at a Big 4 firm. Anne specialises in tax advisory and compliance services for financial services clients and in particular, all aspects of investment managers and funds, including the multi-year QI audit of a private client investment manager.

Anne is also currently a Vice Chairman of the AIMA tax committee and a member of their FATCA working group.