

# FATCA Highlights

## Proposed Regulations: Reducing the Burden

Released February 2012

Volume 1



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## I. PROPOSED FATCA REGULATIONS RELEASED

On February 8, 2012, the Internal Revenue Service ("IRS") and Department of the Treasury ("Treasury") released proposed regulations for the Foreign Account Tax Compliance Act ("FATCA").<sup>1</sup> Prior to the Proposed FATCA Regulations, the IRS and Treasury released three notices regarding FATCA. The Proposed FATCA Regulations addressed many of the concerns of financial institutions in its attempt to minimize the burden, while promoting the law's goal of combating offshore tax evasion. The Proposed FATCA Regulations also provided significantly more detail than the previous three notices.

## II. FATCA OVERVIEW

On March 18, 2010, FATCA was signed into law as part of the Hiring Incentives to Restore Employment Act. FATCA generally goes into effect on January 1, 2013 and provides the Treasury and the IRS with oversight responsibility. The goal of FATCA is to combat tax evasion by mandating that each participating foreign financial institution ("FFI") report select information on their U.S. Accounts to the IRS.<sup>2</sup> To achieve this goal, in general, FATCA requires FFIs to put processes in place to identify and report their U.S. Accounts to the IRS or suffer a 30% withholding tax.

Participating FFIs will be required to enter into an agreement with the IRS (the "FFI Agreement") to report certain information regarding their account holders and withhold on certain payments, if necessary.

## III. SELECTED HIGHLIGHTS OF THE PROPOSED FATCA REGULATIONS

### A. FATCA Partner Countries: Intergovernmental Cooperation

Treasury issued a joint statement with France, Germany, Italy, Spain and the United Kingdom ("FATCA Partners") expressing an intent to have a mutual intergovernmental framework for FATCA. Under this proposed framework, each country's FFIs will be required by local law to collect the required account information and report it to their own country's tax authority. Each country's own tax authority will then provide the necessary information to the IRS. FFIs from FATCA Partner countries will not have to sign an FFI Agreement with the United States. It is believed the mutual intergovernmental framework for FATCA developed for the FATCA Partners will serve as a model for additional countries.<sup>3</sup> There are no country exceptions to FATCA.

### B. Pre-Existing Accounts: Due Diligence Requirements

There were numerous changes made in the Proposed FATCA Regulations to address concerns raised by the financial services industry concerning the due diligence of pre-existing accounts. These changes generally reduce the implementation burden put on FFIs to identify indicia of a U.S. account.<sup>4</sup>

<sup>1</sup> Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, Department of Treasury and Internal Revenue Service, 26 CFR Parts 1 and 301, REG-121647-10, RIN 1545-BK68, released February 8, 2012 ("Proposed FATCA Regulations")

<sup>2</sup> According to FATCA, an FFI is a foreign entity that: (1) accepts deposits in the ordinary course of a banking or similar business, (2) as a substantial portion of its business, holds financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading securities, partnership interests, commodities, or any interest in these mentioned items. Internal Revenue Code ("IRC") § 1471(d)(5).

<sup>3</sup> For a complete description of FATCA Partner countries see Joint Statement from United States, France, Germany, Italy, and the United Kingdom Regarding an Intergovernmental Approach to Improve International Tax Compliance and Implementing FATCA, Department of Treasury, released February 8, 2012, available at <http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf>.

<sup>4</sup> Indicia of U.S. accounts ("U.S. indicia") are the following: (a) Identification of an account holder as a U.S. resident or citizen; (b) U.S. place of birth identified for the account holder; (c) U.S. resident address or U.S. mailing address (including a U.S. post office box); (d) U.S. telephone number; (e) Standing instructions to transfer funds to an account maintained in the United States; (f) Power of attorney or signatory authority granted to a person with a U.S. address; or (g) An "in-care-of" address or "hold mail" address that is the sole address the FFI has identified for the account holder. Proposed FATCA Regulations § 1.1471-4(c)(4)(i)(A).

## 1. Aggregation of Accounts

One area of frustration for many FFIs related to the previous, ambiguous rules regarding the aggregation of accounts. The Proposed FATCA Regulations require that accounts be aggregated according to reference data available to the FFI and the FFI's relationship manager's knowledge.

### a. The Use of Reference Data

For purposes of determining the balance or value of accounts, the FFI is required to aggregate account values if its computerized systems link the accounts by reference to a specific data element. This aggregation could occur across a single FFI or an expanded affiliated group.

### b. Relationship Manager Knowledge

If there are relationship managers affiliated with accounts, the FFI is required to aggregate account values if the relationship manager knows or has reason to know the accounts in question are owned, controlled or established (other than in a fiduciary capacity) by the same person.

## 2. Analysis of Individual Accounts

The Proposed FATCA Regulations removed the private banking distinction for pre-existing accounts that had required greater due diligence procedures and raised the aggregated account value for enhanced review to \$1,000,000 ("High Value Accounts"). For High Value Accounts, FFIs will have to assess any relationship manager knowledge of the account holder's U.S.

status, to query electronically searchable information<sup>5</sup> for indicia of a U.S. account and, if the electronically searchable information does not contain certain information, an enhanced review of a paper file is required. The enhanced review requires a manual review of paper or imaged documents including (1) the customer master file,<sup>6</sup> (2) certain, recently acquired documentary evidence, (3) the most recent account opening contract or documentation, (4) the most recent documentation obtained by the participating FFI for purposes of anti-money laundering ("AML") due diligence or for other regulatory purposes, (5) any power of attorney or signature authority forms currently in effect and (6) any, in effect, standing instructions to transfer funds.

For accounts whose aggregated value is between \$50,000 and \$1,000,000, FFIs will only be required to conduct a query of electronically searchable information for U.S. indicia.

## 3. Analysis of Entity Accounts

The Proposed FATCA Regulations raised the account value threshold to \$250,000 for pre-existing entity accounts.

### a. FFIs

Generally, if an entity account holder is a FFI, the FFI conducting the analysis on its account holders can rely on documentation and representations made by the account holder, subject to confirmation and, at times, validation, to determine the account holder's status as a participating

<sup>5</sup> Electronically searchable information means information that an FFI maintains in its tax reporting files, customer master files, or similar files, that is stored in the form of an electronic database against which standard queries in programming languages, such as Structured Query Language, may be used. Information, data, or files are not electronically searchable merely because they are stored in an image retrieval system (such as portable document format (.pdf) or scanned images). Proposed FATCA Regulations § 1.1471-1(b)(16).

<sup>6</sup> A customer master file includes the primary files of a participating FFI or deemed-compliant FFI for maintaining account holder information, such as information used for contacting account holders and for satisfying AML due diligences. Proposed FATCA Regulations § 1.1471-1(b)(12).

FFI, deemed compliant FFI, or FFI excepted from FATCA compliance.

b. Excepted NFFEs

For account holders that are non-financial foreign entities ("NFFEs"), the analysis is different depending on whether the NFFE account holder is excepted or not excepted from FATCA withholding. Statutory excepted NFFEs are excepted from the withholding requirement and include publicly traded corporations, certain territory entities and NFFEs with exempted beneficial owners, such as foreign governments.<sup>7</sup>

Active NFFEs are excepted from FATCA withholding by the Proposed FATCA Regulations. An Active NFFE is an entity that derives less than 50% of its income from certain types of investments and holds less than 50% of assets that are a type that produces passive income.<sup>8</sup> Active NFFEs will generally operate an active trade or business.

c. Non-Excepted NFFEs

Passive NFFEs are NFFEs that are not excepted.<sup>9</sup> If for a passive NFFE account holder the previous year-end balance or value of the account is less than \$1,000,000, the FFI conducting the analysis can rely on its local AML/"know your customer" ("KYC") laws to identify beneficial ownership if the laws of the jurisdiction are Financial Action Task Force ("FATF") compliant. If the balance or value

of the account is greater than \$1,000,000, the FFI has to identify substantial U.S. owners, which under FATCA generally means greater than 10% ownership by a U.S. person.<sup>10</sup>

**C. Withholding: Phased Implementation**

The withholding requirements will be phased in gradually with the expectation that FFIs, unless they are intermediaries, will not have to withhold until 2017. Select U.S. sourced payments will have to be withheld upon starting January 1, 2014. The earliest that passthru payments will need to be withheld on is January 1, 2017.

**D. Reporting: Gradual Implementation**

Reporting, similar to withholding, will be phased in starting in September 2014. To start, FFIs will have to report the name, address, taxpayer identification number ("TIN"), account number and account balance on U.S. accounts. Starting in 2016, FFIs will be required to report on U.S. sourced income and an aggregate of the payments made to a non-participating FFI. In 2017, FFIs will be required to report on the gross proceeds from the sale of certain assets. Moreover, if the account is in the name of a U.S. owned foreign entity, the participating FFI will also have to report the name, address and TIN (if any) of the U.S. owned foreign entity.

**E. Deemed-Compliant FFIs: Category Expanded**

The definition of deemed compliant FFIs has been expanded to cover more financial organizations. The Proposed FATCA Regulations distinguish between two types of deemed compliant FFIs: registered and certified. Registered deemed compliant FFIs include local FFIs, non-reporting members of

<sup>7</sup> Proposed FATCA Regulations § 1.1472-1(c)(1).

<sup>8</sup> Active NFFE is defined as "an NFFE if less than 50% of its gross income from the preceding calendar year is passive income or less than 50 percent of the assets that are held by the NFFE at any time during the preceding calendar year are assets that produce or are held for the production of passive income." Proposed FATCA Regulations § 1.1472-1(c)(1)(v).

<sup>9</sup> A passive NFFE is any NFFE other than an excepted NFFE. Proposed FATCA Regulations § 1.1471-1(b)(36)(iii).

<sup>10</sup> Proposed FATCA Regulations § 1.1473-1 (b)

participating FFIs and qualified investment vehicles and must certify compliance every three years to the IRS. Certified deemed-compliant FFIs include retirement plans, non-profit organizations and non-registered local banks and must certify to their withholding agents. Certified deemed-compliant FFIs do not have to register with the IRS.

#### **F. Compliance: Time to Get Started**

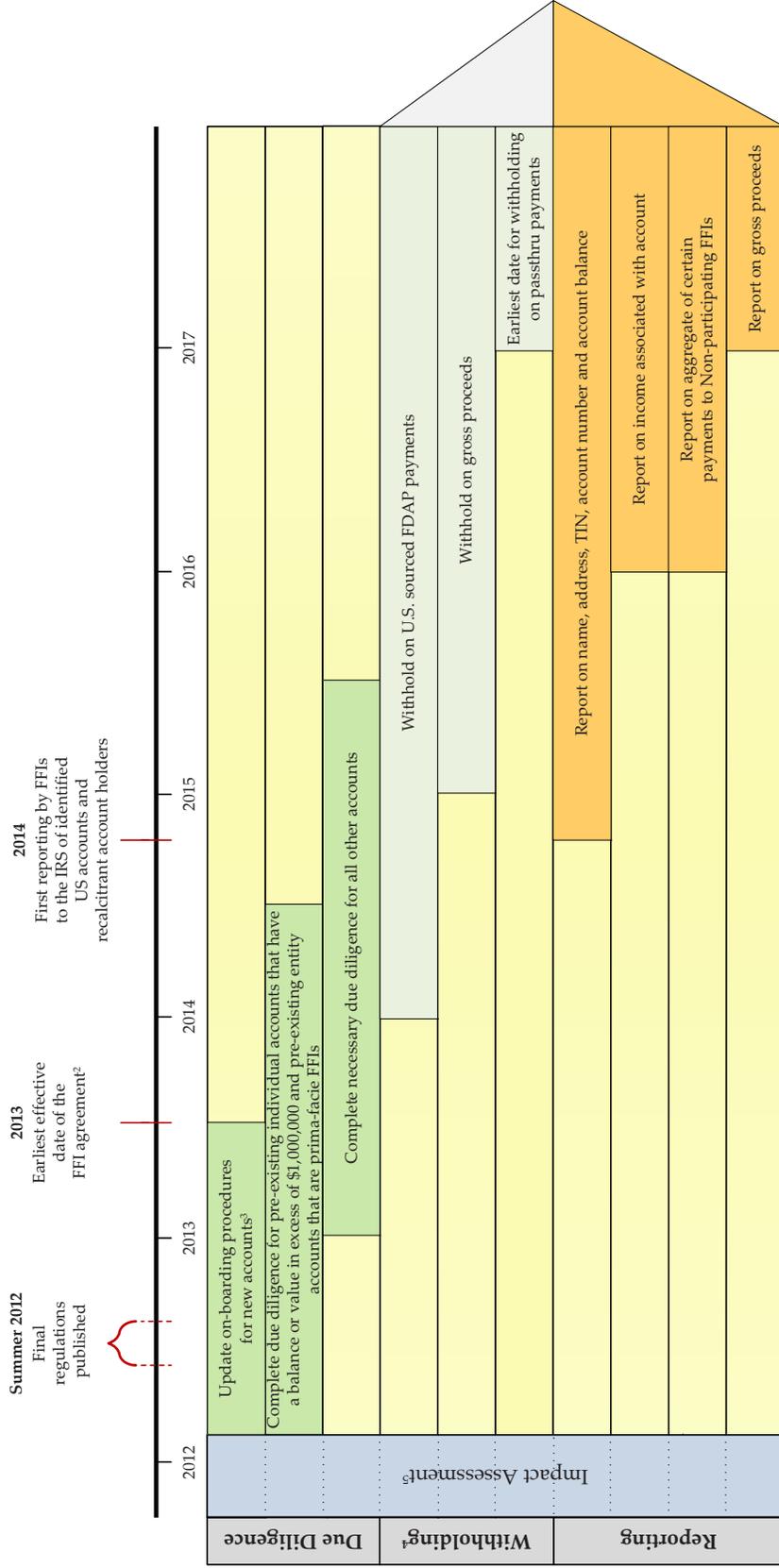
FFIs are required to have an FFI compliance program in place by July 1, 2013. Responsible FFI officers, who are no longer defined in the regulations as Chief Compliance Officers or equivalent level officers, must certify compliance starting in 2014. The first certification indicates that the pre-existing account analysis was completed within one year of signing the FFI agreement for High Value Accounts and a later certification confirms that the analysis on pre-existing financial accounts was completed within two years of signing the FFI agreement. The certification also includes that the FFI did not have any formal or informal practices in place starting August 6, 2011 to assist account holders in avoidance of FATCA.

Moreover, third party audits are not mandated, but the FFI is required to conduct internal reviews of their FATCA compliance program.

## **IV. CONCLUSION**

The Proposed FATCA Regulations give FFIs more time to implement certain steps to become FATCA compliant and reduce the implementation burden as compared to the previously issued Notices on FATCA. To assist with the work ahead, an updated FATCA timeline incorporating many of the items discussed in this document follows.

## Appendix A Proposed FATCA Regulations Sample Implementation Schedule<sup>1</sup>



1. The amount of time necessary to complete each of the above tasks will vary by institution.

2. This timeline assumes the FFI enters into an FFI Agreement by June 30, 2013.

3. According to the proposed regulations preamble, "[f]or individual accounts opened after the effective date of an FFI's agreement, the FFI will be required to review the information provided at the opening of the account, including identification and any documentation collected under AML/KYC rules. If U.S. indicia are identified as part of that review, the FFI must obtain additional documentation or treat the account as held by a recalitrant account holder. Accordingly, FFIs will generally not need to make significant changes to the information collected during the account opening process in order to identify U.S. accounts, except to the extent that U.S. indicia are identified." (Proposed FATCA Regulations, p. 23)

4. Generally, FFI withholding, except for intermediaries, does not go into effect until January 1, 2017. The impact assessment includes, among other things, the legal entity analysis, an inventory of affected business lines, product, services and account holders, a determination of information maintained on account holders and the identification of affected information technology systems.

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