# FATCA: the end of hiding US accounts in foreign banks?

On 17 January 2013, the US Department of Treasury and the Internal Revenue Service issued comprehensive final regulations implementing the information reporting and withholding requirements that were mandated by the Foreign Account Tax Compliance Act ('FATCA') - an act targeting offshore tax shelters. Michelle W. Cohen and Steven Eichorn, of Ifrah PLLC, discuss the legislative history of FACTA, the causes for concern and the likelihood of successful implementation.

## Legislative history of FATCA

Congress enacted FATCA in 2010 as a component of the Hiring Incentives to Restore Employment (HIRE) Act. FATCA was part of a congressional response to address and curb perceived tax abuses by US persons with offshore bank accounts and/or investments. The pervasive belief behind the legislation was that many offshore accounts were created to evade or minimise US tax liability. Therefore, Congress wanted to ensure that persons with offshore accounts also pay their 'fair share' of taxes. In its efforts to curb the abuse of offshore accounts by US persons, Congress passed broad-sweeping legislation that was intended to cast a wide net and greatly increase the US authorities' ability to collect data about offshore accounts and thereby aid in combating offshore tax evasion. While there are certain '*de minimis*' rules exempting individual accounts of less than $50,000 and other exceptions, the law also allows for aggregation of accounts by an account holder.

The FATCA statute only provided general guidance regarding the new withholding and reporting rules. The law deferred much of the administration and implementation of the new reporting regime to the US Department of Treasury ('Treasury') and the Internal Revenue Service ('IRS'). The final regulations issued by Treasury and the IRS clarify the responsibilities and obligations imposed on financial institutions and/or foreign government counterparts. They also provide a step-by-step due diligence process for US account identification, information reporting, and withholding requirements for foreign financial institutions (FFIs), other foreign entities, and US withholding agents. FATCA has a nearly universal application - it applies to virtually all non-US entities, receiving most types of US source income, including gross proceeds from the sale or disposition of US property that can produce interest or dividends. Additionally, US entities, both financial and non-financial, that make payments of most types of US source income to non-US persons may potentially be required to withhold a 30% tax on that income paid to a non-US person under FATCA.

## Requirements & agreements

As expected, the final regulations did not materially change the reporting and withholding requirements from the proposed regulations. Generally, FATCA requires FFIs and non-financial foreign entities ('NFFEs') to comply with certain due diligence and reporting requirements with respect to their US accountholders and substantial US owners, respectively. In order to reduce administrative burdens for financial institutions with operations in multiple jurisdictions, the final regulations provide for the coordination of the obligations for financial institutions under the regulations and the intergovernmental agreements. Notably, the issuance of the final regulations also marked a key step in establishing a common intergovernmental approach to combating tax evasion. Because many foreign jurisdictions have laws that do not permit direct compliance by FFIs with FATCA's reporting and withholding requirements, the Treasury Department has been negotiating intergovernmental agreements to address these impediments. The Treasury Department has collaborated with foreign governments to develop and sign intergovernmental agreements that facilitate the effective and efficient implementation of FATCA by eliminating legal barriers to participation, reducing administrative burdens, and ensuring the participation of all non-exempt financial institutions in a partner jurisdiction. (To date, intergovernmental agreements have been signed by Denmark, Ireland, Mexico, Norway, Spain, Switzerland and the United Kingdom. The Treasury Department has further indicated that it is conducting ongoing negotiations for similar intergovernmental agreements with at least 50 other countries).

Treasury's collaboration with foreign governments has yielded the development of two alternative model intergovernmental agreements that facilitate the effective and efficient implementation of FATCA - a reciprocal version and a nonreciprocal version. The model agreements contain many of the same provisions. For example, both versions establish a framework for reporting by financial institutions of certain financial account

information to respective tax authorities, followed by the exchange of such information under existing bilateral tax treaties or tax information exchange agreements. Both versions of the model agreement also address the legal issues that had been raised in connection with FATCA, and simplify its implementation for financial institutions.

More specifically, the two alternative intergovernmental agreements that have been developed are as follows.

In the first model agreement, the partner jurisdiction agrees to enact legislation that will require local financial institutions to report FATCA information directly to the foreign partner jurisdiction. The foreign partner jurisdiction will then provide this information to the IRS. While FFIs in such a country will be deemed to be in compliance with the requirements under FATCA by reporting directly to that country (instead of to the IRS), they will still be required to register and confirm their status through the IRS portal (a secure, worldwide accessible portal that will be developed as part of the implementation of FATCA).

This version of the model also provides for the United States to exchange information currently collected on accounts held in US financial institutions by residents of partner countries, and includes a policy commitment to pursue regulations and support legislation that would provide for equivalent levels of exchange by the United States. This version will be available only to jurisdictions with which the United States has in effect an income tax treaty or tax information exchange agreement. Further, it is only available in instances where the Treasury Department and the IRS have determined that the recipient government has in place robust protections and practices to ensure that the information remains confidential and that it is used solely for tax purposes.

In the second model agreement, the partner jurisdiction agrees to enact legislation that will enable and direct local financial institutions to report directly to the US IRS, thereby complying with FATCA's reporting and withholding requirements. In order to enter into the second model agreement, the jurisdiction is required to have a local law that would permit the exchange of information with the United States.

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## Data collection and privacy concerns

Although the main goal of FATCA was to target evasion of US tax liability by US taxpayers using foreign accounts, the final regulations provide for a very broad reach by US authorities to obtain a tremendous amount of sensitive data on both foreign account assets and account holder information. There is also little chance of escaping FATCA's reach by hiding behind the banking secrecy laws of other nations because the FATCA rules require that FFIs ask any US customer to waive their rights under the privacy or secrecy rules so that the FFI can report their information to the US Government. If the customer refuses to provide this waiver, then the FFI is required to close the account.

Consequently, in addition to the obvious ramifications to US persons with offshore assets that may have run afoul of US tax laws, there will also be a significant quantity and quality of data collected on perfectly compliant US persons with offshore accounts - in many ways, even more significant than the data collected on accounts located in the US.

This poses significant data and privacy concerns as many countries have stricter privacy laws concerning data transfer than does the United States. And some, like Switzerland, have already expressed concerns that the model agreement does not conform to data privacy regulation. Certain countries may refuse to enter into intergovernmental agreements because of these privacy concerns.

## Strong likelihood of successful implementation

Despite the potentially burdensome requirements, the cooperation by foreign financial institutions is virtually assured because of the severe consequences to financial institutions (which will be passed onto their clients) for non-compliance. Specifically, FATCA incorporated a new reporting regime that imposes a significant withholding tax (up to 30%) on certain foreign entities that refuse to comply with all of the reporting requirements. If an FFI or NFFE fails to comply with these requirements and is otherwise not excepted, exempted or deemed compliant by the applicable regulations, a 30% withholding tax will be imposed on US-source interest, dividends, rents, and salaries (generally referred to as US-source FDAP income) as well as gross proceeds from the sale of debt and equity instruments that produce US-source FDAP income.

While placing the primary burden on the financial institutions may seem to be a somewhat circuitous method of encouraging compliance by US persons with foreign accounts, this method has been utilised successfully by the US government in other areas. For example, the Unlawful Internet Gambling Enforcement Act of 2006 (or UIGEA) was legislation that attempted (and was pretty

successful) at regulating online gambling by preventing the financial institutions from processing gambling proceeds. UIGEA 'prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the internet and that is unlawful under any federal or state law.' UIGEA also required Treasury and the Federal Reserve Board (in consultation with the US Attorney General) to promulgate regulations requiring certain participants in payment systems that could be used for unlawful internet gambling to implement and enforce policies and procedures designed to identify and block, or otherwise prevent, the processing of restricted transactions. The US government's success against online poker gaming operators and other online payment processors stemmed largely from these regulations that were aimed at the underlying financial system. Likewise, the Treasury regulations implementing FATCA are squarely focused on the financial institutions, and not on the individual account owners. This approach is definitely more efficient (by focusing on institutions that have numerous account owners and are already significantly regulated) rather than individual audits and/or monitoring, and promises to be quite successful, just like the regulations under UIGEA.

## Certifications, verification & consolidated compliance

As noted earlier, an FFI will be subject to the FATCA withholding tax unless it enters into an agreement with Treasury and becomes a 'participating FFI' (or 'PFFI') (or it otherwise qualifies for an exemption). The agreement with Treasury will mandate the PFFI perform certain due diligence, reporting and withholding functions. For example, a PFFI will be required to obtain and report certain information with respect to financial accounts held by specified US persons or US-owned foreign entities. In addition, it will be required to withhold FATCA tax from defined categories of payments that it makes to recalcitrant account holders (e.g. those not waiving the protection of local banking secrecy regulations).

The final regulations also paralleled the proposed regulations in regard to periodic certifications from a PFFI's responsible officer. Pursuant to the final regulations, the initial certification will relate to the more immediate implementation of policies and procedures, and, a written assurance that the due diligence procedures have been carried out in the time frame set forth in the regulations.

In addition, the responsible officer must certify that there were no formal or informal practices in place to assist account holders to avoid the impact of the new FATCA rules. In response to interested party requests, Treasury and the IRS listed a few examples of the types of unacceptable practices to avoid the impact of the new FATCA rules. A sampling of the examples was: suggesting the bifurcation of accounts to avoid certain account identification requirements, suggesting an account holder remove US indicia from the account, or suggesting that the account holder close the account.

Further, as it relates to compliance, the final regulations provide that a PFFI must establish and implement a compliance program for satisfying its requirements under its FFI Agreement. As part of the compliance program, the PFFI must appoint a responsible officer to establish and oversee its compliance program. The compliance program must include policies, procedures, and processes sufficient for the PFFI to satisfy its requirements under its FFI Agreement. In addition, the responsible officer must periodically review the sufficiency of the established compliance program. The results of these reviews must be considered when the responsible officer makes periodic compliance certifications to the IRS.

## Conclusion

It was always understood that FATCA would have a huge impact on the FFIs and the costs of doing business with US clients. However, it is now equally clear that FATCA has enabled the US government to obtain access to large quantities of data on the foreign accounts of US citizens. While the US will need to conclude many additional intergovernmental agreements, and some nations may refuse to enter into these agreements (like China), it is nevertheless accurate to state that Americans seeking to avoid tax liability by maintaining offshore accounts will face a substantial foe under FATCA.

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