Nations' Domestic FATCA Requirements Could Complicate Compliance, Practioners Say

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BNA Snapshot

Interviews on FATCA Implementation, Compliance

Diverse Views: Practitioners in Europe and the U.S. have various opinions about whether differences among FATCA intergovernmental agreements could raise compliance issues for companies.

Common Concern: Many agree, however, that possible differences among countries' domestic implementation requirements could create more challenges than FATCA agreements themselves.

By Rick Mitchell

Aug. 26 — The U.S. has signed several dozen bilateral intergovernmental agreements since 2012 in an effort toward uniform implementation of the international tax information reporting standard set out in the Foreign Account Tax Compliance Act.

The agreements, referred to as IGAs, have differences, stemming chiefly from specific laws and types of financial institutions in the various jurisdictions, tax practitioners told Bloomberg BNA in July and August interviews.

Practitioners disagreed on whether those IGA differences could seriously complicate FATCA compliance for businesses. And, although FATCA implementation is still in its early stages, they cautioned that the domestic obligations and penalties foreign governments could impose to implement FATCA agreements may create stricter compliance obligations than FATCA itself does.

The recent French law that would levy a small per-account fine on institutions deemed noncompliant with FATCA reporting obligations is an example of how domestic statutes could add to compliance burden and costs on business, they said.

National guidance notes on FATCA implementation and the Organization for Economic Cooperation and Development's work on a common reporting standard for automatic exchange of information (AEOI) could help alleviate that burden, but must be well-coordinated with other efforts, practitioners said.

80,000 Registrations

The 2010 FATCA statute added Chapter 4 to the Internal Revenue Code setting, out a system requiring virtually all foreign financial institutions to report certain U.S.-owned accounts and assets directly to the Internal Revenue Service or face a withholding tax of up to 30 percent on their own U.S. income and assets.

In addition, the U.S. Treasury set out detailed rules and procedures in its FATCA regulations.

The U.S. cannot directly impose FATCA's legal reporting obligation on non-U.S. persons with no connection to the U.S., so it imposes that obligation on U.S. withholding agents, institutions or other entities making payments to non-U.S. financial institutions.

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But early objections by some jurisdictions to this unilateral U.S. approach led the U.S. to also jointly develop with France, Germany, Italy, Spain and the United Kingdom, the “Group of Five” countries, an alternative AEOI framework to implement FATCA (26 DTR GG-3, 2/9/12).

Growing out of this effort, the U.S. released two model IGAs in July 2012. The effort also eventually led to development of the OECD's international common reporting standard for AEOI, which draws heavily on FATCA.

“The U.S. government is trying to get as much information about U.S. depositors and owners as it possibly can from anybody around the world,” said H. David Rosenbloom at Caplin & Drysdale.

When the regime came into force July 1, some 80,000 institutions had registered to report account information directly to the IRS (127 DTR G-1, 7/2/14).

More Than 90 IGAs

Model 1A IGAs, which stress improving tax compliance internationally, call for financial institutions to report U.S.-owned accounts of $50,000 or more to their domestic tax authorities, which then report FATCA information to the IRS. They also foresee that the U.S. will implement reciprocal AEOI with the FATCA partner.

As of Aug. 20, Treasury's website listed 36 jurisdictions that had signed Model 1A IGAs, and 52 more that had reached such agreements in substance.

By contrast, Model 2 IGAs focus on bilateral tax cooperation between the U.S. and the partner country and target countries that lack AEOI provisions. Model 2 foresees the partner jurisdiction will permit institutions to report directly to the IRS, but does not call for reciprocal information exchange from the U.S.

Model 2 is favored by countries with strong privacy and banking secrecy laws, said Maryte Somare, a researcher who has studied FATCA IGAs for the Vienna-based Institute for Austrian and International Tax Law.

Treasury listed only five jurisdictions that have signed Model 2 IGAs, including Switzerland and Japan, and eight—including Hong Kong and Taiwan—that have reached such agreements in substance.

Somare said Treasury also released Model 1B and 2B sub-versions, for jurisdictions lacking tax treaties or tax information exchange agreements with the U.S., but that virtually all signed IGAs to date are Models 1A and 2, and mostly 1A.

IGA Language Governs

Somare said institutions in jurisdictions that have signed IGAs technically only have to follow the parts of the FATCA regulations and the Internal Revenue Code that the agreements specifically refer to, but that the models frequently refer to that language, although in differing degrees.

The two models are similarly structured, with preamble and main articles setting out the agreement's purpose, scope, legal basis and definitions.

Model 1A's Article 3 covers deadlines for implementation of the FATCA AEOI standard. Since Model 2 is largely based on the Treasury regulations and the tax code, it doesn't have this language, said Somare.

Both models address noncompliance. Model 1A addresses future consultation and cooperation on AEOI, application and amendments to FATCA, its consistent application and how long the agreement lasts.

Due Diligence Requirements

Both models have two annexes, with Annex I setting out due diligence requirements.

“Annex 1 [in Model 1] details types of accounts that need to be flagged, the required information, and timing of the report that the foreign jurisdiction must submit to the U.S. in order to meet its obligation and what the reporting thresholds are,” said Manal Corwin, national leader of international tax practice at KPMG LLP.

“That will give an institution a lot of insight around what it has to do to on-board a new account and to meet its obligations to identify existing accounts. It's not like big institutions will be flying blind,” said Corwin, who was deputy assistant secretary for tax policy for international affairs at Treasury when the government launched its IGA initiative.

The IGAs do not themselves set out an AEOI regime but rely on language in existing bilateral tax treaties, TIEAs, or the Multilateral Convention on Mutual Assistance in Tax Matters, she noted.

Differences in Annex II

Somare said essentially all signed FATCA agreements to date closely follow the model IGAs' main text, but Annex II has substantial differences, mainly in lists of institutions and products not subject to FATCA reporting.

Corwin said Annex II gives clarity by identifying specific types of funds or institutions that meet FATCA's exemption standard within a jurisdiction. “The standard was designed to be uniform across agreements and jurisdictions,” not to create implementation differences, she said.

“Of course there are differences in the lists in Annex IIs. For example, Switzerland's Model 2 IGA deals with important Swiss institutions, such as Swiss Foundations, which may not even exist in say, China or Singapore,” Rosenbloom said.

Rosenbloom, who recently negotiated a Model 1 IGA for a jurisdiction, said: “My client insisted on putting in some things that are a little divergent. But just like for tax treaties, there could be variations in the text of IGAs, depending on the particular negotiation and the specific country, but the differences are unlikely to have much cross-border impact.”

“[The U.S.] is not trying to do one-off deals with countries and give them unique terms,” he added.

Rely on Treasury Definitions

Alan Schwartz, a New York-based partner at McDermott Will & Emery LLP working in international tax matters, said differences in jurisdictions' IGA Annex IIs do raise issues for international entities.

For example, specific countries' Annex IIs list specific entities as exempted beneficial owners, or otherwise being compliant with FATCA. “That comes up frequently with retirement plans. You need to actually confirm the specific plan status in each Annex II of each jurisdiction you're dealing with,” he said.

Schwartz said a key issue is that some Model 1 IGAs don't contain certain definitions contained in the Treasury regulations. For example, some investment entities, treasury centers and holding companies are not explicitly defined in the IGAs.

Some of the earlier negotiated IGAs included specific permission to rely on fund definitions in the FATCA Treasury regulations when they are not defined in the IGA itself, and such permission allows the entity to get clarity as to its status as exempt or not.

“But other IGAs require the IGA partner to make a determination on whether it will allow its residents to rely on the regulations,” Schwartz said.

Corwin said that even if a particular IGA does not reference Treasury-regulation definitions, Treasury lacks authority to deem a non-U.S. financial institution noncompliant and impose the withholding penalty, if that institution is meeting all obligations or requirements in the FATCA statute and regulations.

“That may not answer the question of whether the domestic implementation could have a different standard or definition, but until it does, I think it's a safe bet to rely on the U.S. Treasury regulation definition,” said Corwin.

W-8BEN-E Guidance Needed

Schwartz said the IRS’ W-8BEN-E Form, Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities) is an example of an area where more FATCA guidance is needed.

The law requires foreign entities to present the form to their withholding agents, who must then establish whether, when and how much to withhold. In late June, the IRS issued instructions for the form (123 DTR G-5, 6/26/14).

For non-U.S. retirement funds, “If you look at the form's part 12, for nonreporting IGA foreign financial institutions, it states that they are treated as a ‘blank’ under the provisions in the particular IGA's Annex II. The instructions just say you have to list the specific type of entity from Annex II, but it doesn't give any additional guidance as to how deep you can go in the annex,” he said.

Treasury's Model 1 IGA lists three categories of exemptions. By contrast, the U.K. lists a category of exempt beneficial owners, under which are listed government organizations, central bank, international organizations and retirement funds, he said.

The U.K. FATCA guidance says there will be another category for deemed compliant funds that will have other subcategories of not-for-profits, local client-based institutions, and other exempt categories, said Schwartz.

“For non-U.S. retirement funds I have been advising, there is a preference to be treated as exempt under Annex 2 of an IGA rather than under one of the other categories of the Treasury regulations. [That is] because the other categories require analysis as to specific criteria in the fund itself, whether it's broad-based or narrow-based, whereas if you just list it in Annex 2 of an IGA that's the answer. It exempts you,” he said.

Guidance Notes

Schwartz cited the U.K., Ireland and the Cayman Islands as among a handful of jurisdictions to release FATCA implementation guidance notes to date, while the Luxembourg bankers' association has issued unofficial interpretive notes.

“One thing coming up frequently now is a need to classify multinational holding companies under FATCA, particularly in the Luxembourg and the Netherlands, where the IGAs don't provide adequate definitions,” he said.

“Under the regulations, these holding companies would clearly be excepted nonfinancial entities, [and] on that point, the U.K. guidance notes and the Luxembourg association guidance allow people to rely on the regulations for purposes of classifying the holding company,” Schwartz said.

The problem with FATCA guidance documents to date is that, although they have very similar ideas, they also have differences, he said.

IGA Terms ‘Lack Clarity.'

Practitioners would prefer to see guidance notes based on one model, rather than each jurisdiction coming up with its own interpretive guidance, said Schwartz. “The U.K. guidance notes could be a good model that could be used by other countries, but to date, no country has adopted the U.K.’s or another country's guidance notes, whole cloth, as their own,” he added.

Corwin said “most jurisdictions know the U.K. implementation guidelines were adopted in heavy consultation with the U.S. I know the Crown Dependencies and possibly some overseas territories are looking to those implementation guidelines as a model. Financial institutions will likely use that as guidance when there might be questions in other jurisdictions.”

Many FATCA terms and phrases in IGAs “lack clarity,” so guidance notes would clearly make compliance easier, said Rosenbloom, adding, “I think the IRS and Treasury would be inclined, in the absence of stiff resistance from the other side, to use [the U.K.] guidance notes in interpreting IGAs that don't have guidance notes.”

Domestic Implementation Concerns

Rosenbloom said the degree of compliance with FATCA IGA Model 1 will depend on what local authorities require as they put in place processes for getting information that they can turn over to the U.S. “That is going to vary country-by-country, at the least,” he said.

Jurisdictions are free to impose a stricter standard, such as requiring reporting of accounts under $50,000—even of all accounts—or setting tighter deadlines, and to set their own noncompliance penalties, Corwin said.

She said that although IGAs spell out a lot of FATCA details, compliance can nevertheless be “frustrating and difficult for financial institutions, especially with worrying about whether domestic implementation standards will vary.”

“I know that business is very concerned about the possibility of differences in implementation standards,” she said.

French Noncompliance Fine

Domestic FATCA measures could boost jurisdictions' own efforts to fight offshore tax evasion, but there have been few examples of such measures to date, Corwin said.

Frederic Teper, a Paris-based partner at Arsene Taxand, said France has already inserted an article into its tax code to address FATCA; among other things, it imposes a fine of 200 euros ($265) per customer for institutions failing to report FATCA information to the French tax authority.

The fine could be significant for institutions that have many U.S. clients, but it is unlikely to be dissuasive for big investment funds that might have just a handful of U.S. clients, said Teper, adding that he expects the fine to be increased, but that the tax authority has yet to set its own FATCA reporting deadline.

“That is causing some uncertainty,” he said.

Corwin said institutions are unlikely to try to game national penalty structures, “because the potential of a U.S. withholding penalty is a significant risk in the first instance.”

Expectations for OECD Standard

Teper said, “French paying establishments have long been obligated to communicate interest payment information to the French tax authority, under France's reporting obligations under the EU Savings Directive.”

On top of that, OECD's broader FATCA-inspired common AEOI standard will apply to accounts worldwide, not just U.S. accounts. “Even if there is an effort to harmonize all these different [EU, OECD and U.S.] efforts, there is definitely a risk that different reporting thresholds, schedules, and other obligations could cause complications and raise costs for banks,” he said.

But Corwin said financial institutions hope OECD's common reporting standard “will help create more standardization around information collection and a reporting format, as close as possible to FATCA's standard so that they don't need to have different reporting standards in every jurisdiction.”

“Business will feel much better when they see a little more commonality and more guidance from each jurisdiction,” said Corwin.

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For More Information

Treasury's updated list of IGA signatories is at http://www.treasury.gov/resource-center/tax-policy/treaties/pages/fatca-archive.aspx.

Links to the text of U.S. Tax Code Chapter 4, Taxes To Enforce Reporting On Certain Foreign Accounts, are at http://www.law.cornell.edu/uscode/text/26/subtitle-A/chapter-4.

IRS resources and on FATCA regulations and guidance are at http://www.irs.gov/Businesses/Corporations/FATCA-Regulations-and-Other-Guidance.