

## Summary

- **Aim:** to counter tax evasion by US taxpayers. Primary goal is information gathering not raising tax revenue.
- **How:** by imposing a 30% withholding tax on payments to non-US financial institutions and foreign funds unless those institutions/funds identify US account holders/investors and provide the IRS with information on them.
- **Result:** huge administrative burden for non-US banks and financial institutions and potential impact for anyone dealing with any non-US bank/financial institution.
- **When:** phased implementation from 2013 to 2017 (see the Appendix for a FATCA timeline).
- **Position of UK financial institutions:** the UK has entered into an Agreement with the US which simplifies FATCA compliance for UK financial institutions – see [below](#) for further details.

## What is FATCA?

FATCA means the Foreign Account Tax Compliance Act (which was incorporated into the HIRE Act) which became law on 18 March 2010.

FATCA's aim is to reduce US tax evasion by requiring foreign firms to provide the IRS with information about the offshore accounts of US persons.

## What does FATCA do?

FATCA imposes a 30% withholding tax on withholdable payments to foreign financial institutions (FFI) and non-financial foreign entities (NFFE).

## What is a FFI?

A non-US person will be treated as a FFI if:

- it accepts deposits;
- holds financial assets for the account of others; or
- engages primarily in the business of investing, re-investing or trading in financial assets or derivatives, including funds, commodities, partnership interests and other investment vehicles.

## What is a 'withholdable payment'?

The definition of a '**withholdable payment**' includes US source income and the gross proceeds from the

sale of any property that could produce interest or dividends from US sources.

Withholding may also apply to non-US source payments because of the concept of 'passthru payments' (see [below](#)).

## How to avoid the withholding tax

The withholding tax will not apply to a FFI that enters into a FFI Agreement with the IRS. A FFI that enters into a FFI Agreement will become a Participating FFI (PFFI).

PFFIs must:

- identify all financial accounts held by US persons ('US accounts');
- collect and report certain information on US accounts to the IRS on an annual basis; and
- withhold 30% on certain 'passthru payments' to non-participating FFIs and 'recalcitrant account holders'.

A FFI must enter into a FFI Agreement by 30 June 2013 to ensure that it will be identified as a PFFI that will not be subject to withholding when withholding commences on 1 January 2014. The draft FFI Agreement has not yet been released by the IRS.

## Are some FFIs exempt?

Yes. Certain foreign entities that would be FFIs solely because they are engaged primarily in investing, reinvesting or trading in securities are excepted FFIs (i.e. they will not be classed as FFIs). These include:

- **non-financial holding companies** - non-US entities whose primary purpose is to act as a holding company for a subsidiary or group that primarily engages in a non-financial business;
- **hedging/financing centre of a non-financial group** - non-US entities that primarily engage in financing/hedging transactions with or for members of their own non-financial group (e.g. group finance companies).

Certain FFIs will be deemed to be compliant FFIs without having to sign a FFI Agreement with the IRS. Deemed compliant FFIs are relieved from FATCA withholding - i.e. they will not suffer FATCA withholding on payments to them and do not have to apply FATCA withholding on passthru payments to others.

Under the Agreement between the US and the UK on implementing FATCA, UK financial institutions will be treated as deemed compliant FFIs.

## 'Passthru payments'

A PFFI must withhold tax on payments to:

- any account holders that are FFIs and do not enter into an FFI Agreement with the IRS or comply with other procedures to ensure that no account holders are US persons (non-participating FFIs); and
- any recalcitrant account holders - that is, individuals or entities that refuse to provide a PFFI with information about their US or non-US status.

Withholding is on any payment to such an account holder in proportion to the ratio of the PFFI's US assets to its total assets. So, the withholding obligation does not only apply to payments that are directly traceable to US financial assets; it extends to payments that the PFFI makes on its own behalf (e.g. payments of principal and interest on deposits).

For example, a PFFI that is a bank would be required to withhold tax on payments of principal and interest made in respect of a deposit held by a non-participating FFI, based on the ratio of the PFFI's US assets to its total assets.

## Grandfathered obligations

The withholding under FATCA does not apply to any payments made pursuant to an 'obligation' entered into before **1 January 2013**.

## Intergovernmental approach

The UK and the US signed an Agreement setting out how FATCA will be implemented by UK financial institutions on 14 September 2012. France, Germany, Italy and Spain intend to enter into similar agreements with the US.

The Agreement provides that:

- UK financial institutions (UK FIs):
  - will not have to enter into separate FFI Agreements with the IRS;
  - will not be subject to FATCA withholding;
  - will not have to withhold under FATCA on non-US source passthru payments to other FFIs (whether those FFIs are FATCA compliant or not);
  - will not have to withhold under FATCA with respect to an account held by a recalcitrant account holder or close an account held by a recalcitrant account holder;

provided that they:

- comply with certain registration requirements (it is not clear yet whether UK FIs will have to

register with the IRS or with HMRC) or are excepted from being registered by the FATCA legislation or the Agreement;

- identify 'US accounts' and provide HMRC with information on those accounts on an annual basis;
  - report annually to HMRC the name of, and the aggregate amount of any payments made in 2015 and 2016 to, non-participating FFIs;
  - impose withholding on US source passthru payments to non-participating FFIs or provide any immediate payor of such US source withholdable payments with the necessary information to allow the payor to withhold and report.
- HMRC will provide the IRS with all the information it receives on 'US accounts' from UK FIs.
  - The benefits of the Agreement can be disapplied if there is significant non-compliance by a UK FI. The UK FI would then be treated as a non-participating FFI.
  - Under the Agreement certain UK FIs (e.g. some retirement funds, charities and local banks) are deemed to be FATCA compliant or are otherwise exempt from FATCA reporting.

Details of the UK domestic legislation to implement the terms of the Agreement are due to be published later this year. It is not clear whether UK banks or financial institutions will be able to opt out of the domestic scheme if they elect not to comply with FATCA.

Although there is now greater certainty for UK FIs, it is not clear which other jurisdictions (aside from the G5) will enter into similar agreements with the US or whether, if they do, the terms will be the same. This leaves multi-nationals facing the prospect of having to understand and implement different versions of FATCA in different jurisdictions.

## When does FATCA come into force?

FATCA reporting and withholding is being implemented in phases from 2013 to 2017.

See the Appendix for a FATCA timeline.

**This note provides a brief overview of the FATCA regime as we understand it. We are not able to provide US tax advice and this note should not be relied on as legal or tax advice.**

# FATCA (Foreign Account Tax Compliance Act)

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## FATCA timeline

### APPENDIX

