

ClientAlert

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An Intergovernmental Approach to FATCA: US Treasury Issues Joint Statement From the United States, France, Germany, Italy, Spain and the United Kingdom in Connection With the Issuance of Proposed FATCA Regulations

I. Introduction

On February 8, 2012, the Department of Treasury (the "Treasury") and the Internal Revenue Service (the "Service") issued proposed regulations under the Foreign Account Tax Compliance Act ("FATCA"). FATCA establishes a new US information reporting regime that requires foreign financial institutions ("FFIs") to agree to provide the United States with specific information about their US account holders or be subject to a 30 percent withholding tax on various categories of US source payments and certain passthru payments received from other FFIs. The proposed regulations incorporate, refine and modify prior FATCA guidance as well as provide guidance on topics not previously addressed.

In connection with the issuance of the proposed regulations, the Treasury issued a Joint Statement from the United States, France, Germany, Italy, Spain, and the United Kingdom setting forth the framework for an intergovernmental approach to FATCA implementation in lieu of requiring FFIs established in those countries to report directly to the Service. The Joint Statement addresses concerns raised by governments, financial institutions and practitioners that FATCA reporting may violate various foreign privacy and data protection laws.

II. Joint Statement for an Intergovernmental Approach

The Treasury has acknowledged that there may be existing conflicts between FATCA reporting requirements and various laws of foreign jurisdictions. In particular, many FFIs established in foreign countries may not be able to comply with FATCA reporting, withholding and account closure requirements because of local law restrictions. In order to address this concern, the Treasury and the Service have considered, in consultation with foreign governments, an alternative approach to FATCA. In a Joint Statement, the United States, France, Germany, Italy, Spain and the United Kingdom have agreed to explore an intergovernmental approach to FATCA implementation. We also understand the Treasury to be in discussions with other countries, including Japan and China, to finalize similar agreements.

The Joint Statement lists a possible framework for an agreement to implement FATCA between the United States and an applicable foreign country (referred to in the Joint Statement as a "FATCA partner"). Under this framework and subject to the terms negotiated in each specific agreement, the applicable foreign country would agree



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to (i) pursue the necessary implementing legislation to require FFIs in its jurisdiction to collect and report to the authorities of the foreign country the information required under FATCA, (ii) permit such FFIs that are not otherwise exempt under FATCA to apply the necessary diligence to identify their US account holders, and (iii) automatically transfer the information reported by such FFIs to the United States. This framework would allow the Service to identify each FFI established in the applicable foreign country as a deemed-compliant FFI or participating FFI and would therefore eliminate the need for such an FFI to enter into an agreement with the Service to avoid FATCA withholding. However, each FFI generally would be required to register with the Service, which would likely require an FFI to apply for a FATCA identification number through an online process.

In addition, the Joint Statement provides that the United States will commit to reciprocity with respect to collecting and automatically reporting to the authorities of the applicable foreign country information on the US accounts of the foreign country's residents. It is not clear from the Joint Statement as to what extent the United States will agree to provide reciprocal information to foreign countries, although any such commitment to reciprocity would seem to require future revisions to US law.

The Joint Statement also provides that the United States and an applicable foreign country will work to develop a practical alternative to passthru payment withholding that minimizes the administrative burden on FFIs established in such foreign countries. Accordingly, FFIs established in each applicable foreign country would not be required to impose passthru payment withholding on payments to other FFIs organized in the same country or in another country with which the United States has a FATCA implementation agreement.

Many questions and challenges still remain in connection with the FATCA implementation framework set forth in the Joint Statement. For instance, it is unlikely that the United States would be able to negotiate and finalize FATCA implementation agreements with each applicable foreign country prior to January 1, 2013 (the expected date on which FFIs will be permitted to enter into an FFI agreement). In addition, it remains unclear as to whether an agreement between the United States and an applicable foreign country would solve all potential conflicts of laws issues arising in a specific jurisdiction. For example, consideration will need to be given as to whether a FATCA implementation agreement entered into between the United States and a European Union member country would satisfy the laws or regulations of the European Union. Finally, it is likely that other countries besides the countries issuing the Joint Statement will request to enter into similar arrangements with the United States, and we would expect the United States to permit additional countries to enter into such arrangements.

III. Proposed Regulations Under FATCA

FFIs in countries that do not enter into a FATCA implementation agreement with the United States will be required to enter into a reporting agreement with the Service (an "FFI Agreement") to avoid imposition of the new FATCA withholding tax. FFIs that enter into an FFI Agreement are referred to below as "participating FFIs." This discussion summarizes the important changes contained in the proposed regulations from earlier guidance contained in the Notices issued by the Treasury and the Service. (For our prior discussions on these Notices, please see our Alerts from [September 2010](#), [April 2011](#) and [July 2011](#)).

A. Extension of the Grandfather Provision

FATCA withholding is scheduled to apply to payments of US source dividends, interest, and other fixed payments as of January 1, 2014 and to US source payments of gross proceeds from the disposition of property that can produce such payments on January 1, 2015. A grandfather provision treats "obligations" that are outstanding on or before a specific date and payments of gross proceeds from the dispositions of such obligations as exempt from FATCA withholding. Prior guidance provided a grandfather date of March 18, 2012. The proposed regulations have extended the grandfather date and provide that FATCA withholding does not apply to any obligation outstanding on January 1, 2013 and to payments of gross proceeds from the disposition of such obligation, unless such obligation is materially modified after that date.

An obligation that constitutes indebtedness for US federal income tax purposes will be treated as outstanding on January 1, 2013 only if it is issued before January 1, 2013. The proposed regulations clarify that a binding agreement to extend credit for a fixed term (e.g., a revolving loan facility) will be treated as an "obligation" outstanding for purposes of the grandfather provision, provided that on the issue date of the agreement, the material terms of the credit which is to be provided are fixed. Legal agreements or instruments that are treated as equity for US tax purposes do not qualify as obligations for purposes of the grandfather provision.

B. Expanding the Categories of Deemed-Compliant FFIs

Prior guidance under FATCA identified certain FFIs as "deemed-compliant" FFIs that may avoid FATCA withholding without entering into an FFI Agreement. The proposed regulations implement the exclusions identified in the prior guidance, treating certain local banks, local nonreporting members of participating FFI groups and a limited category of investment funds as deemed-compliant FFIs. Furthermore, the proposed regulations expand the categories of deemed-compliant FFIs to include certain banks and investment funds conducting business only with local clients and certain

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low-risk entities, subject to certain restrictions. The proposed regulations also treat certain retirement and pension funds as deemed-compliant FFIs provided that such funds are regulated under local law and meet certain requirements.

The proposed regulations provide that certain deemed-compliant FFIs must register with the Service, meaning that they must certify to the Service that they meet the requirements of an applicable deemed-compliant category, agree to the conditions for deemed-compliant status and renew their certification every three years (or earlier if there is a change in circumstance). Other deemed-compliant FFIs are not required to register with the Service but must certify to a withholding agent that they meet the requirements of their certified deemed-compliant category.

C. Exclusion of Certain Securities From the Definition of “Financial Account”

The proposed regulations narrow the definition of a “financial account” to focus on traditional bank, brokerage, money market accounts and interests in investment vehicles. Certain regulated retirement and pension accounts and most debt and equity securities issued by banks and brokerage firms are now excluded from the term “financial account.”

D. Phase-In of Information Reporting Obligations

The proposed regulations provide that reporting obligations with respect to US accounts will be phased in beginning in 2016 (with respect to the 2015 calendar year) and reporting obligations on gross proceeds will begin in 2017 (with respect to the 2016 calendar year).

E. Passthru Payment Dates Extended

The proposed regulations provide that participating FFIs will not be required to withhold on passthru payments made before January 1, 2017 (extended from January 1, 2015). However, participating FFIs will be required to report annually to the Service the aggregate amount of certain passthru payments.

F. Transitional Rules for Members of Expanded Affiliated Groups

The FATCA provisions generally provide that the withholding, reporting and other requirements imposed on an FFI shall apply with respect to all FFIs that are members of the same “expanded affiliated group.” The Treasury and the Service previously stated their intent to require that each FFI affiliate of an FFI group be a participating FFI or deemed-compliant FFI in order for any FFI in the expanded affiliate group to enter into an FFI agreement. The proposed regulations provide a two-year transitional period

(until January 1, 2016) for the full implementation of this requirement in situations where an FFI affiliate is located in a jurisdiction that prohibits reporting or withholding under FATCA. However, the proposed regulations do not provide how this issue will be resolved after the two-year transitional period ends.

G. Modification of Account Due Diligence Procedures

The proposed regulations set forth due diligence procedures for participating FFIs to identify their US accounts (which include accounts held by US individuals and entities as well as accounts held by foreign entities with substantial US owners), making certain changes to the due diligence procedures outlined in prior guidance in an attempt to reduce the administrative burden on FFIs. As in prior guidance, the diligence procedures set forth in the proposed regulations distinguish between individual accounts and entity accounts and between preexisting accounts and new accounts. A brief summary of the due diligence procedures under the proposed regulations are as follows:

- **Preexisting Individual Accounts:** Accounts with a balance or value that does not exceed US\$50,000 (calculated under certain aggregation rules) are exempt from due diligence review. Other accounts will be subject only to review of electronically searchable data for indicia of US status, unless the balance in the account exceeds US\$1,000,000, in which case enhanced due diligence requirements will apply. These enhanced due diligence requirements may include a review of non-electronic files and an inquiry as to the actual knowledge of any relationship manager associated with the account. Participating FFIs will not be required to distinguish between individual private banking accounts and other individual accounts.
- **New Individual Accounts:** For individual accounts opened after the effective date of the participating FFI’s FFI Agreement, the FFI will be required to review the information provided at the opening of the account, including identification and any documentation collected under anti-money laundering/“know your customer” rules. With this approach, participating FFIs generally should not need to make significant changes to the information collected during the account-opening process unless US indicia is identified with respect to the account holder.
- **Preexisting Entity Accounts:** Accounts with a balance or value that does not exceed US\$250,000 (calculated under certain aggregation rules) will be exempt from due diligence review. With respect to other accounts, participating FFIs generally will be able to rely on anti-money laundering/“know your customer” records to determine what type of entity the account holder is under the FATCA rules.
- **New Entity Accounts:** Subject to certain exceptions, participating FFIs generally will be required to determine whether the entity has any substantial US owners upon opening a new account, generally by obtaining a certification from the account holder.

The proposed regulations further provide that a “responsible officer of the participating FFI” must certify that the FFI has complied with the terms of the FFI agreement and make other certifications pursuant to FATCA. Prior guidance had identified a participating FFI’s “chief compliance officer” as an appropriate person to make such representations.

IV. Public Comments and Future Guidance

The Treasury and the Service request electronic or written comments on all aspects of the proposed regulations by April 30, 2012. A public hearing has been scheduled for May 15, 2012; persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed by May 1, 2012.

The Treasury and the Service expect to issue future guidance on topics not covered in the proposed regulations. Such guidance includes a draft model FFI agreement and draft forms relating to FATCA reporting, as well as future regulations that provide guidance on substantive procedural issues. We will keep you informed of any important updates.

Before the FATCA withholding requirement begins on January 1, 2014, it is likely that many countries will pursue the intergovernmental approach proposed under the Joint Statement and begin negotiations of FATCA implementation agreements with the United States. As a result, the procedures described under the proposed regulations may become less of a concern for governments, financial institutions and practitioners in many foreign countries and the framework described in the Joint Statement could become the avenue through which information targeted by FATCA legislation will be obtained.

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