

ClientAlert

Legal framework for FATCA in the Russian Federation

August 2014

Special Alert

On 30 June 2014 Law No. 173-FZ “On specifics of financial operations with foreign citizens and legal entities, on amendments to the Code of the Russian Federation on Administrative Offences (...)” dated 28 June 2014 (the “Law”) entered into force.

The Law establishes the legal framework for Russian financial institutions to comply with reporting obligations imposed by the U.S. Foreign Account Tax Compliance Act (known as FATCA).

The Law does not expressly mention FATCA, but refers to “foreign states’ laws on foreign account taxations that are in effect when the Law enters into force”. As on 30 June 2014 FATCA was the only such “foreign law”.

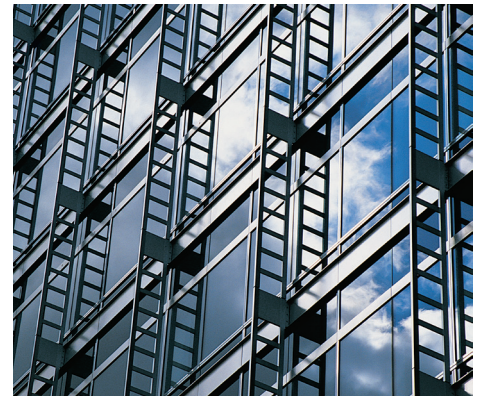
1. FATCA

FATCA was adopted on 18 March 2010 with the aim to ensure that US persons with non-US “accounts” are not allowed to use these non-US accounts to conceal their income and assets so as to avoid US taxation. FATCA requires foreign financial institutions (“FFIs”) to enter into reporting agreements with the US Internal Revenue Service (the “IRS”) to report information with respect to their US persons’ accounts. FATCA imposes a 30% withholding tax on certain US source payments made to non-participating entities.

The FATCA requirements to report to the IRS and withhold tax in relation to US source income that is fixed or determinable, annual or periodical, such as interest, dividends, rent, salaries, wages, premiums, and annuities, became effective on **1 July 2014**. It is expected that such requirements in relation to gross proceeds from dispositions of instruments that generate the aforementioned categories of income and in relation to foreign passthru payments, shall become effective on **1 January 2017**.¹

1.1 Regime of intergovernmental agreements to implement FATCA

Recognizing the serious conflict of law issues FATCA raised, the United States Treasury and the IRS put in place a regime of intergovernmental agreements (“IGAs”) between the United States and other jurisdictions to implement FATCA. The United States has entered into IGAs with 39 jurisdictions and has reached agreements in substance with respect to an IGA with 62 other jurisdictions. The IRS will treat a jurisdiction that has reached an agreement in substance with the United States as having an IGA in effect until the end of 2014 provided a definitive agreement is signed by 31 December 2014.



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¹ For more details please see our [April 2011](#), [June 2012](#), [January](#) and [July 2013](#) Client Alerts.

There are two different model IGAs. Under the Model 1 IGA, FFIs are not required to enter into a reporting agreement with the IRS. Instead, FFIs provide information on US persons' accounts to their local government agencies rather than directly to the IRS, and these agencies will transfer the information to the United States.² A FFI located in a jurisdiction with a Model 2 IGA must enter into a reporting agreement with the IRS. Similarly, a FFI located in a jurisdiction which does not have an IGA must enter into a reporting agreement with the IRS or suffer the 30% withholding tax discussed above. A FFI enters into a reporting agreement by accessing and completing the agreement that is available through the IRS website.

The Russian Government's preference has been to regulate FATCA compliance mechanism in an IGA (presumably, Model 1 IGA). The negotiation process on concluding the IGA was, however, terminated in April 2014.

1.2 Reporting obligations of foreign financial institutions under FATCA

A FFI that enters into an agreement with the IRS will be subject to extensive reporting obligations in relation to direct and indirect "US account holders," i.e. *customers that are subject to FATCA*. In accordance with FATCA, the following persons shall be recognized as customers that are subject to FATCA ("**US persons**" or "**reportable persons**"): (i) a citizen or a resident of the United States, (ii) a US partnership, (iii) a US corporation, (iv) any estate other than a non-US estate,³ (v) any trust if (A) a court within the United States is able to exercise primary supervision over the administration of the trust and (B) one or more US persons have the authority to control all substantial decisions of the trust, (vi) certain non-US insurance companies that have made elections to be treated as US insurance companies for US tax purposes.

A FFI that entered into an agreement with the IRS is generally required to report the following information: (i) name, address, and US tax identification number of each account holder that is a specified US person; (ii) the account number; (iii) the account balance or value of the account as of the end of the relevant calendar year; and (iv) the payments made with respect to the account during the calendar year. However, for calendar years 2014 and 2015, such FFI is only required to report information mentioned in items (i), (ii) and (iii) above. The FFI must report each direct and indirect US account to the IRS on an annual basis on

or before March 31 of the year following the end of the calendar year.⁴ It will also be required to agree itself to withhold tax as required on applicable payments that it makes to non-participating FFIs and recalcitrant account-holders.

2. Russian Law No. 173-FZ

2.1 Applicability to financial institutions operating in Russia

The Law applies to certain financial institutions that operate in Russia with regard to their reportable persons.

The scope of **financial institutions** under the Law (matches to a greater extent but not fully to FATCA definition of FFIs) includes the following:

- credit organizations;
- voluntary life insurance organizations;
- professional securities market participants such as brokers, securities' management companies, depository institutions, clearing institutions;
- asset management companies;
- non-state pension funds, non-state pension funds' management companies;
- joint stock investment funds, investments funds management companies, mutual funds management companies.

The Law does not define the scope of *reportable persons* (i.e., persons that are subject to foreign states' laws on foreign account taxation). Instead it delegates the determination of the criteria of *reportable persons* (i.e., US persons) to Russian financial institutions that in turn have obviously to follow the FATCA directly.

The following persons are *explicitly excluded* from the reporting obligation ("**non-US persons**"):

- Russian citizens except for those who have other (different from Kazakhstan, Belarus) states' citizenship(s) or residence permit(s) (e.g., a green card);
- Russian legal entities that are by more than 90%, directly or indirectly, controlled by the Russian state or Russian citizens (as described above).

2 The concept underlying the Model 1 IGA is similar to that proposed by the Organization for Economic Co-operation and Development (the "**OECD**") in the global standard for exchange of financial account information approved by the OECD Council on 15 July 2014. This standard provides for the model bilateral agreement on automatic exchange of financial account information through the competent authorities on a bilateral basis and the reporting and due diligence standards for financial institutions that need to be incorporated into domestic laws.

3 Under FATCA, the term "US persons" includes the so-called "US estates". According to the US legislation, US estates are legal entities (similar to trusts in essence) that possess property of the deceased person before it is distributed among heirs.

4 Generally, jurisdictions that have entered into a Model 1 IGA with the United States will exchange information with the United States within 9 months of the calendar year-end. However, information with respect to 2013 will be exchanged no later than 30 September 2015.

2.2 Russian legal framework for reporting compliance under FATCA

Notably, the Law deals only with reporting obligation but does not address tax withholding requirements under FATCA.

Internal regulations. Financial institutions shall adopt “internal regulations” determining (i) criteria of reportable persons (US persons) and (ii) information collection methods. Regulations shall be published on an official website of the respective financial institution and are subject to monitoring by the Russian Central Bank.

Due diligence. Reasonable measures are to be undertaken to identify US persons among current or new clients entering into financial services agreements with financial institutions.

Information transfer consent. For transfer of the information to the IRS, a customer’s consent is required. Such consent simultaneously covers the transfer of the information to the Russian Central Bank, the Federal Tax Service, and Federal Service for Financial Monitoring (*Rosfinmonitoring*) (“**authorized bodies**”).

Notifications of Russian authorized bodies. Financial institutions must render the following notifications (within specific deadlines):

- *on registration with the IRS* – to the Russian Central Bank;
- *on reportable customer (once identified)* – to the “authorized bodies” in accordance with procedure to be enacted;
- *on information request (once received from the IRS)* – to the “authorized bodies” in accordance with procedure to be enacted;
- *on information transfer to the IRS (at least ten days prior to transfer)* – to the “authorized bodies” in accordance with procedure to be enacted.

Reporting to the IRS. The Law permits reporting *only if* the customer’s consent is received *and* no prohibition on the information transfer is issued by the Rosfinmonitoring.

Stop of operations for the benefit, or on behalf, of the customer and contract termination.

If a customer fails to respond to due diligence requests and/or to provide consent within specific term (e.g. fifteen days for consent), the financial institution is *allowed to stop operations* for such a customer (except for payments under enforcement documents, salary, mandatory social contributions, taxes, transfers to the customer’s other bank accounts, disbursements), or *to unilaterally terminate* the customer’s contract. With regard to new customers, the financial institution is allowed to refuse the contract signing.

2.3 Liability for non-compliance with the Law

The Law introduces administrative fines for incompliance with notification requirements:

Types of incompliance with requirements related to notifications on:	Fines (in RUB)	
	for financial institutions	for financial institutions’ officers
■ registration with the IRS	500,000 – 750,000	30,000 – 40,000
■ reportable customer ■ information request received from the IRS	300,000 – 500,000	20,000 – 30,000
■ information transfer to the IRS in violation of the Rosfinmonitoring’s prohibition or in absence of customer’s consent	750,000 – 1,000,000	40,000 – 50,000

2.4 New requirements for foreign (non-Russian) financial institutions

The Law introduces the obligation for foreign financial institutions to (by 30 September of a following year) report annually to the Russian Federal Tax Service details of all financial accounts opened for Russian citizens and Russian legal entities abroad.