

## **FATCA: Frequently Asked Questions – The Basics**

### **What is FATCA?**

FATCA stands for the Foreign Account Tax Compliance Act. Enacted by Congress on March 18, 2010, the IRS and the U.S. Department of Treasury Final issued final regulations implementing the Act on January 17<sup>th</sup>, 2013.<sup>1</sup> The following is a link to the full text of the final regulations: <http://www.irs.gov/PUP/businesses/corporations/TD9610.pdf>

FATCA was designed to prevent U.S. citizens from evading taxes through the use of offshore accounts and to improve tax compliance involving foreign financial institutions (FFI). It is a potentially powerful new tool in the U.S. government's campaign against offshore tax evasion and was prompted in part by the well-publicized prosecution of a large Swiss bank that facilitated U.S. tax evasion.

Broadly speaking, FFIs will be required to enter into an agreement with the IRS and disclose certain information regarding U.S. account holders or be subject to a penalty tax.

### **Who is impacted by FATCA?**

FATCA has a wide breadth of applicability, as virtually all non-U.S. entities receiving most types of U.S. income are required to comply. FATCA has a direct and profound impact on FFIs that have U.S. investments or accounts holders

### **What does FACTA Require?**

FATCA has three main parts:

1. Foreign banks and foreign financial institutions (FFI) are required to disclose to the IRS information about financial accounts held by U.S. taxpayers, including their balances, receipts, and withdrawals. Failure to comply will result in a 30% withholding tax on income from U.S. financial assets held by the banks or financial entities.
2. U.S. taxpayers with foreign financial assets that exceed certain thresholds must report those assets to the IRS on Form 8938. Account holders would be subject to a 40% penalty on understatements of income in an undisclosed foreign financial asset.
3. FATCA also closes a tax loophole that investors have used to avoid paying any taxes on dividends by converting them into dividend equivalents.

### **What qualifies as a Foreign Financial Institution (FFI)?**

An FFI is defined as any financial institution that is a foreign entity, other than a financial institution organized under the laws of a U.S. territory. Section 1471(d)(5) defines a financial institution as any entity that:

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<sup>1</sup> FATCA was included in the Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147 (H.R. 2847)(the "HIRE Act"). FATCA added a new chapter 4 to the income tax subtitle of the Code.

- Accepts deposits in the ordinary course of a banking or similar business;
- As a substantial portion of its business, holds financial assets for the account of others;  
or
- Is engaged (or holds itself as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnerships interests, or commodities.

The FFI designation is quite broad. Thus, foreign banks, brokers, custodians and funds, including foreign mutual funds, funds of funds, exchange-traded funds, private equity and venture capital funds, other managed funds, commodity pools and hedge funds all qualify as an FFI.

### **What does FATCA require of FFIs?**

FATCA requires that FFIs withhold a 30% tax on any Withholdable Payments (as defined below) unless it:

- Enters into a FFI Agreement (a “Participating FFI”) with the IRS under section 1471(b)(1),
- Meets the necessary requirements prescribed by the Treasury Department and the IRS (a “Complying FFI”), or
- Is *excepted* from application of FATCA (e.g. a governmental entity, foreign central bank)

### **What is a Withholdable Payment?**

Essentially, a Withholdable Payment can be thought as a potential penalty imposed on any U.S. source income in the event the FFI does not comply with FACTA. It is broadly defined to include:

1. Any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, and other fixed or determinable annual or periodical games, profits and income (FDAP income), if such payment is from sources within the U.S; and
2. Any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the U.S.

### **What is an FFI Agreement?**

As discussed above, a FFI can become a participating FFI by entering into an agreement (FFI Agreement) with the IRS and thus avoid the 30% withholding tax. Described in more detail below, the agreement requires the FFI to identify U.S. Accounts and comply with verification and due diligence procedures.

### **What does the FFI Agreement require?**

A participating FFI is required to report certain information on an annual basis to the IRS with respect to each U.S. Account and to comply with requests for any additional information with respect to those accounts. The information that must be reported with respect to each U.S. Account includes:

- The name, address, and taxpayer identification number (TIN) of each account holder that is a specified U.S. person and, in the case of any account holder that is a U.S. owned foreign entity, the name, address and TIN of each substantial U.S. owner of such entity;
- The account number;
- The account balance or value; and

- The gross receipts and gross withdrawals or payments from the account

### **What is a U.S. Account?**

A U.S. account is any Financial Account held by one or more Specified U.S. Persons or U.S. Owned Foreign Entities, subject to certain exceptions. Further, Section (d)(2) defines a Financial Account to mean any depository account, custodial account, and any equity or debt interest in an FFI, other than interests that are regularly traded on an established securities market.

### **What is a U.S. Owned Foreign Entity?**

Section 1471(d)(e) defines it as any foreign entity that has one or more substantial U.S. owners

### **How does a FFI become a compliant FFI and not have to enter into a FFI Agreement?**

There are two procedures for FFIs to avoid having to enter into an FFI Agreement because, for example, it may not have US Accounts (we can't capitalize US Accounts in places and not in others):

- First, if the FFI complies with such procedures as the IRS may prescribe to ensure that the FFI does not maintain US Accounts and the FFI meets such other requirements as the IRS may prescribe, with respect to accounts of other FFIs maintained by the first FFI.
- Second, If the FFI is a member of a class of institutions with respect to which the IRS has determined that the application of the agreement/withholding provisions is not necessary.

### **What happens if an account holder doesn't provide the necessary information to the FFI so that the FFI cant determine if it's a U.S. account?**

Any account holder that fails to provide the information required to determine whether the account is a U.S. account, or the information required to be reported by the FFI, or that fails to provide a waiver of a foreign law that would prevent reporting is considered to be a recalcitrant account In this situation, a participating FFI is required to withhold 30% of any Withholdable Payment (capitalize or not?) or other payment to the extent attributable to a withholdable payment.

### **What happens if a country's privacy laws prohibit a FFI from releasing private information about its account holders?**

If foreign law would prevent the FFI from reporting the required information absent a waiver from the account holder, then the FFI is subjected to requiring U.S. account holders to provide such a waiver. If the account holder fails to provide a waiver within a reasonable period of time, the FFI is required) to close the account.

### **When should an FFI enter into an FFI Agreement?**

Notice 2011-53 details that an FFI which enters into an FFI Agreement by June 30<sup>th</sup> 2013 will be identified as a Participating FFI (defined term earlier? Capitalized earlier should be here as well) and will thus avoid withholding that begins January 1, 2014.

### **How does a FFI register with the IRS?**

A FFI can register through an online portal and will be added to a published IRS FFI list.

### **What are the important dates for FATCA registration and compliance?**

FFIs will be able to register through an electronic online portal that will be available in July 2013. Information on the registration process is available at <http://www.irs.gov/Businesses/International-Businesses/Draft-Form-8957-FATCA-Registration-Process>. Currently, a draft of the registration form is open to public review and comment and is available [http://www.irs.gov/pub/irs-utl/13f8957\\_040113.pdf](http://www.irs.gov/pub/irs-utl/13f8957_040113.pdf).

The IRS will electronically post the first IRS FFI list in December 2013. The last date by which a FFI can register to ensure its inclusion on the December 2013 FFI list is October 25, 2013.

### **Why would a FFI agree to comply with FACTA?**

FFIs with any meaningful direct or indirect exposure to the U.S. capital markets will not have much of an option. Even if it chooses not to cooperate, applicable FFI's will still be subject to the 30% withholding tax on all income and proceeds from its direct or indirect investment in U.S. assets. FFIs that would like to continue to invest on their own behalf or on behalf of clients in the US capital markets will have to agree to comply with the new provisions to avoid the tax. Rather than incurring the withholding tax, certain FFIs may choose to cease holding U.S. securities for their own account and not have U.S. account holders or, alternatively, cease to maintain accounts on behalf of US persons unless they hold only non-U.S. securities.