FATCA Compliance through Intergovernmental agreement approach

Contents

1. Introduction

The U.S. Internal Revenue Service (IRS) released the Treasury regulations under sections 1471 through 1474 of the US Internal Revenue Code of 1986, commonly referred to as the Foreign Account Tax Compliance Act (FATCA), with the intention to improve compliance with US tax laws and impose certain due diligence and reporting obligations on foreign (non-US) financial institutions.

Foreign Financial Institutions (FFIs) are finding it difficult to comply with certain aspects of FATCA due to domestic legal impediments.

In response to concerns about the impact of these obligations on FFIs and the non US economy as a whole, Governments across the globe are exploring the feasibility of an inter-governmental agreement (IGA) with the US, with an objective to minimize compliance costs for take holders while enhancing the existing tax cooperation arrangements with the US. In this regard, the US treasury in conjunction with 5 countries has come out model IGAs.

This whitepaper highlights the main differences between the final FATCA regulation and the two forms of IGAs that Treasury has released (referred to as the Model 1 IGA and Model 2 IGA) and some considerations governments may be taking into account when deciding between implementing a Model 1 IGA or Model 2 IGA

2. Background

FATCA was signed into law on March 18, 2010 with the objective to uncover US persons who may be evading US taxes by investing through foreign financial institutions or other foreign entities. To accomplish this goal, FATCA creates a new information reporting and withholding regime, in addition to existing US information reporting and withholding rules.

Although the FATCA legislation is generally effective beginning January 1, 2014, the Regulations phase in the implementation of FATCA over the next several years. FATCA generally requires certain withholding agents, which includes both US and foreign persons, to withhold 30 percent on certain payments made to any

I. FFI, if the FFI does not enter into an agreement with the IRS (FFI Agreement) to report information about its US accounts to the IRS, and

II. Nonfinancial foreign entity (NFFE), if the NFFE (or its beneficial owner, as applicable) does not provide to the withholding agent information about its substantial US owners (generally a US person that owns directly or indirectly more than 10 percent of the NFFE).

III. Recalcitrant accounts

Foreign governments, international organizations, foreign central banks of issue and other entities identified by the IRS as posing a low risk of tax evasion are exempt from withholding under FATCA.

One of the main problems faced by FFIs in their home jurisdiction as a result of the introduction of FATCA, is that obligations imposed by FATCA fail to take account of domestic rules (for example, data protection rules and confidentiality issues) prohibiting the sharing of the information sought by the IRS. Therefore, an FFI (otherwise willing to share information with the IRS) may (some might say somewhat unfairly) be subject to withholding tax on account of FATCA on payments it receives merely because it complies with the laws of the jurisdiction where it is located (or operates).

3. Model Intergovernmental Agreement to FATCA compliance

To address the legal impediments to comply with FATCA regulations issue, in conjunction with the release of the proposed FATCA regulations on February 8, 2012, the US Treasury issued a statement reporting that it was working with five European countries to develop an intergovernmental framework to implement FATCA.
This framework was designed to "address legal impediments to compliance, simplify practical implementation, and reduce FFI costs." The framework described in the statement developed into what is now known as the Model 1 IGA. The US Treasury released the Model 1 IGA comprising of two versions (reciprocal and non-reciprocal), in draft form on July 26, 2012

Under a Model 1 IGA, FFIs will not enter into FFI Agreements with the IRS but instead will provide required information to the relevant FATCA Partner. In general, the reciprocal version requires an exchange of information between the IRS and the FATCA Partner with respect to information about account holders in each country's financial institutions that are residents of the other country. The nonreciprocal version requires reporting only by the FATCA Partner to the IRS.

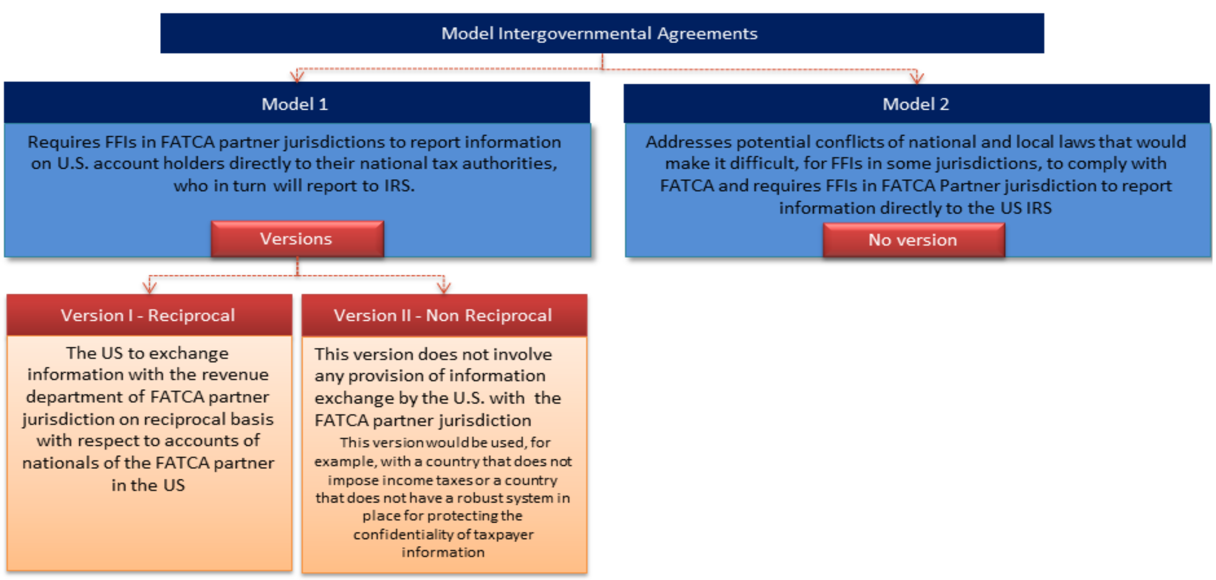
Under a Model 1 IGA, FFIs are generally required to report certain information (Reportable Information) about accounts held by US persons or by foreign entities controlled by US persons, including the US taxpayer identification numbers of such persons, and payments made to nonparticipating FFIs (i.e. FFIs that have not entered into an FFI Agreement or are not otherwise deemed to comply with FATCA).

The Model 2 IGA was issued by Treasury in draft form on November 14, 2012. Under the Model 2 IGA, the FATCA Partner will direct and enable each FFI to register and "comply with the requirements of an FFI Agreement, including with respect to due diligence, reporting, and withholding."

Pursuant to the Regulations, such requirements will also include having a responsible officer of each FFI periodically certify to the IRS about the adequacy of the FFI's FATCA compliance program. Unlike under a Model 1 IGA where an FFI will report Reportable Information to the FATCA Partner, under a Model 2 IGA an FFI will report that information directly to the IRS.

Both the Model 1 IGA and Model 2 IGA include Annex II, which is a list of financial institutions and products that are generally exempt from FATCA reporting because they represent a low risk of tax evasion for US persons. One of the biggest challenges in negotiating an IGA will be what entities and products appear on Annex II.

Two model IGAs have been explained through figure 1 below;



4. A comparison between the final FATCA regulation & IGA Model 1&2

A comparison between the final FATCA regulation & IGA Model 1& 2 in terms of due diligence, information reporting, withholding and enforcement requirements, has been detailed below

Area	Issue	Final FATCA regulation	Model 1	Model 2
General	FFI agreement	Subject to specified exceptions, all FFIs must enter into an FFI agreement to avoid withholding.	Not required for resident FFIs.	Resident FFIs must agree to comply with requirements of an FFI Agreement
	Registration with IRS	Required. Reg. §1.1471-4(a)	Required	Required -Article 2(1)(a)
	U.S. reciprocity	No	No except when it's a reciprocal IGA	Optional
	Can resident FFIs be non-participating FFIs?	Yes	Limited to cases of unresolved significant non-compliance Article 5(2)(b)	Limited to cases of unresolved significant non-compliance Article 4(2)
Due Diligence	Due diligence requirements	Reg. §1.1471-4(c)	Annex I	Annex I
	Election to follow due diligence provisions of regulations rather than Annex I	N/A	Yes. Annex I(I)(C)	Yes. Binding subject to material modification rule. Annex I (I) (C)
	Permitted to open undocumented individual accounts	Yes, but subject to a limited cure period. Reg. §1.1471-5(g)(ii)	No, except for de-minimis accounts -Annex I(III)(B)	No, except for de minimis accounts -Annex I(III)(B)
	Permitted to open undocumented entity accounts	Yes, but subject to a limited cure period. Reg. §1.1471-4(c)(3)(ii)	No, however, self-certification may not be required- Annex I(V)(B), (C)	No, however, self-certification may not be required- Annex I(V)(B), (C)
	Required closing of recalcitrant account holders	Yes, Reg. §1.1471-4(i)	No. Article 4(2)	No. Article 4(2)(a)
Information Reporting	Resolution of conflicts of law to permit reporting	No	Yes	Yes
	Reporting of information to local authority or IRS	IRS, Reg. §1.1471-4(d)(3)(vii)	Local Authority, Article 2	IRS, Article 2
	Information reporting requirements	Provided in Reg. §1.1471-4(d)	Specified in agreement Article 2	Based upon regulations Article 2
	Reporting of U.S. accounts	Waiver required from each U.S. account, if reporting is prevented under foreign law §1.1471-4(i)(2)	Automatic for reportable U.S. accounts. Article 2(1)	Consent to report required from each US Account. Article 2(1)
	Reporting of recalcitrant accountholders	Reg. §1.1471-4(d) (6).	Automatic for reportable U.S. accounts. Article 2(1).	Treated as U.S. accountholder , report total number and value, subject to group request by U.S. Art2(2)
Withholding	Resolution of conflicts of law to permit withholding	No	Yes. See, e.g., Article 4(1)(d)	Yes. See, e.g., Article 3(2)(b)
	Withholding on resident FFIs	Yes, withholding applies to any non-participating FFI. Reg. §1.1471-4(b)	No, except in cases of unresolved significant non-compliance-Article 4	No, except in cases of unresolved significant non-compliance. Article 3(1)
	Withholding on nonresident , non-participating FFIs	Yes, withholding applies to any non-participating FFI. Reg. §1.1471-4(b)	Yes. Article 4(1)	Yes, subject to withholding requirements of regulations. Article 2(1)(a)
	Withholding on foreign pass-through payments and gross sales proceeds	Yes, 2017 at the earliest. Reg. §1.1471-4(b)(4)	No. Article 4	No. Article 3
	Withholding on U.S.-source FDAP	Yes, begins in 2014, Reg. §1.1471-4(b)	No. Article 4	No. Article 3

Area	Issue	Final FATCA regulation	Model 1	Model 2
Enforcement	Withholding on recalcitrant account holders	Yes. Reg. §1.1471-4(b)	No. Article 4(2)	No. Article 3(2).
	Enforcement of compliance	Internal compliance program, certifications Reg. §1.1471-4(f)	Local/IRS. Article 5	Local/IRS. Article 4
	Significant non-compliance	Rules provided to cure event of default. Reg. §1.1471-4(g)	Must be resolved within 18 months. Article 5(2)(b)	Must be resolved within 12 months. Article 4(2)

5. A critical evaluation of IGA Model 1&2

A critical evaluation of IGA Model 1 &2 in terms of due diligence, information reporting, withholding and enforcement requirements below may facilitate FFIs and foreign countries to select the appropriate IGA Model for complying with the FATCA requirements

Requirement	IGA Model 1	IGA Model 2
Due diligence	Annex I of this model sets forth due diligence requirements for FFIs to determine whether their accounts and payments are reportable information. As an alternative to the requirements of Annex I, the FATCA partner is permitted to allow its FFIs to apply the more onerous due diligence requirements of the regulations	Similarly, annex I of this model also sets forth due diligence requirements for FFIs to determine whether their accounts and payments are reportable information. As an alternative to the requirements of Annex I, FFIs may apply the more onerous due diligence requirements of the Regulations. However, if an FFI chooses to apply the due diligence requirements of the regulations, it must continue to apply them rather than the requirements of annex I, unless there is a material modification to the regulations. In addition, FFIs must comply with the requirements of an FFI Agreement, including due diligence, unless the Model 2 IGA provides otherwise.
	Consideration: The due diligence requirements are materially the same under both the model. However, FFIs subject to a Model 1 IGA will only be subject to the requirements of the Model 1 IGA, whereas FFIs subject to a Model 2 IGA will generally also be subject to the requirements of an FFI Agreement. Therefore, FFIs may prefer to be subject to a Model 1 IGA.	
Information reporting	FFIs will report reportable information to the FATCA Partner, which in turn will report that information to the IRS. There will be information reporting flowing the other way under the reciprocal version of a Model1 IGA.	FFIs will report reportable information directly to the IRS. However, an FFI must seek the consent of the account holder or nonparticipating FFI to disclose the reportable information to the IRS. For all such persons that fail to provide their consent (Nonconsenting Person), the FFI is required to report aggregate account information. The IRS can then make a group request about such Nonconsenting Persons from the FATCA Partner under an income tax treaty or tax information exchange agreement. An FFI generally will be prohibited from opening a

<table>
<tr><th>Requirement</th><th>IGA Model 1</th><th>IGA Model 2</th></tr>
<tr><td></td><td></td><td>new account or entering into a new obligation with a Nonconsenting Person</td></tr>
<tr><td></td><td colspan="2">Consideration: A Model 1 IGA FATCA Partner will be required to report annually to the IRS reportable information provided by its FFIs. In order to implement the collection of FATCA information in its own jurisdiction, a FATCA Partner may need to adopt internal laws or regulations and enforce them.

This may present an insurmountable administrative burden for a FATCA Partner to enter into a Model 1 IGA if it does not want to invest in the necessary resources for gathering such information from its FFIs and forwarding the information to the IRS. Even in light of this administrative burden, a FATCA Partner may still opt to enter into the reciprocal version of a Model 1 IGA if it wishes to obtain information from US financial institutions to determine whether its tax laws are being evaded by its own residents investing through such institutions.

Although a FATCA Partner’s obligation to participate in the reporting mechanism is far less under a Model 2 IGA, there is still some administrative burden placed on a Model 2 IGA FATCA Partner. Should the IRS seek additional information about Nonconsenting Persons, the FATCA Partner will be obligated to obtain that information from its FFIs and forward it to the IRS.</td></tr>
<tr><td>Withholding</td><td>FFIs generally will not be subject to withholding under FATCA on payments they receive or on payments they make to account holders, provided they comply with the requirements of the this model. Even if an FFI fails to meet its requirements under the IGA, withholding under FATCA will not be imposed on payments to it unless the IRS has included the FFI on the nonparticipating financial institutions list (see below under Enforcement).

However, an FFI subject to a Model 1 IGA that has assumed responsibility for regular withholding under US tax law (i.e., by virtue of being a withholding qualified intermediary, withholding foreign partnership or withholding foreign trust) is required to apply withholding under FATCA on payments of US source fixed or determinable annual or periodic (FDAP) income (e.g., US source interest or dividends) made to a nonparticipating FFI.

If the FFI has not assumed such withholding responsibility, it is required to disclose certain information to the payer of US source FDAP income it is receiving on behalf of a nonparticipating FFI so that the payer may apply the FATCA withholding.</td><td>FFIs subject to a Model 2 IGA, like FFIs subject to a Model 1 IGA, generally will not be subject to withholding under FATCA on payments they receive or on payments they make to account holders, provided they comply with the requirements of the Model 2 IGA.

However, if the FATCA Partner fails to respond within six months to a group request from the IRS for information about a Nonconsenting Person that is an account holder, then until the FATCA Partner supplies such information, the FFI generally will be required to withhold under FATCA when paying such account

i. US source FDAP income
ii. Gross proceeds from the disposition of property of a type that can produce US source dividends or interest
iii. Foreign pass-through payments.

Even if an FFI subject to a Model 2 IGA fails to meet its requirements under the IGA, withholding under FATCA will not be imposed on payments to it unless the IRS has included the FFI on the nonparticipating financial institutions list (see below under Enforcement).

In addition, FFIs subject to a Model 2 IGA will be required to withhold under FATCA when</td></tr>
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Requirement	IGA Model 1	IGA Model 2
		paying a nonparticipating FFI i. US source FDAP income ii. Gross proceeds from the disposition of property of a type that can produce US source dividends or interest iii. Foreign pass-through payments.
	Consideration: Under the Model 1 IGA, there is more certainty that FATCA withholding generally will not apply to payments made by FFIs because the continued exemption from FATCA withholding with respect to such payments does not depend on the FATCA Partner supplying information about Nonconsenting Persons within six months in certain circumstances. Furthermore, FFIs have less withholding responsibility under a Model 1 IGA than a Model 2 IGA. An FFI subject to a Model 1 IGA is required to withhold only US source FDAP income, and only when it is a withholding qualified intermediary, withholding foreign partnership or withholding foreign trust. Such considerations may weigh in favor of implementing a Model 1 IGA rather than a Model 2 IGA	
Enforcement	A FATCA Partner is required to apply its own domestic law (including penalties) to any FFI that the IRS determines is significantly noncompliant with its obligations under a Model 1 IGA. If the noncompliance is not remedied within 18 months, the IRS may revoke the FFI's compliant status and place the FFI on a nonparticipating financial institutions list, and therefore subject payments received by the FFI to withholding under FATCA.	The IRS will notify the FATCA Partner if an FFI is significantly noncompliant with the requirements of the FFI Agreement. If the noncompliance is not remedied within 12 months, the IRS may revoke the FFI's compliant status and place the FFI on a nonparticipating financial institutions list, and therefore subject payments received by the FFI to withholding under FATCA.
	Consideration: Under the Model 1 IGA, enforcement is to be carried out by the FATCA Partner in the first instance whereas under the Model 2 IGA, the FATCA Partner does not serve an enforcement role. Accordingly, FFIs may prefer the Model 1 IGA because they would interact with their own tax authorities at the beginning stages of an enforcement action. A FATCA Partner may also prefer a Model 1 IGA because it offers greater transparency and control regarding FATCA compliance by its FFIs. However, being in charge of enforcement would likely necessitate more administrative and budgetary resources.	

6. Advantage and disadvantage of Model IGA

The comparison between the final FATCA regulation and Model IGAs highlights that Model IGA could provide numerous benefits to a FATCA partner country notably,

- Provides an option to have reciprocal understanding with the U.S. to exchange similar information about the accounts of individuals and entities of FATCA partner countries having accounts in U.S.
- Apparently relies on self-certification rather than a responsible officer as is required under the final FATCA regulation. However by eliminating the responsible officer, the IRS will be putting the responsibility on the institutions. In practice, financial companies will likely need to designate a responsible officer to help monitor compliance.
- Enables FFI to report US account-holder information to the FATCA partner tax authority, pursuant to domestic enabling legislation i.e. application of local law rather than IRS regulations
- Removes 30% withholding and account closure requirements for recalcitrant accountholders

- Makes closer alignment with Anti Money Laundering/Know Your Customer (AML/KYC) rules
- Does not require FFIs established in FATCA Partner jurisdiction to enter into IRS agreements
- Addresses data privacy and customer identification issues

A potential disadvantage of an IGA is the increased complexity for multinational FFIs. Those organizations with multinational operations will need to comply with its home country IGA and potentially other IGAs for the jurisdictions in which it operates, as well as FATCA regulations for those jurisdictions without an IGA.

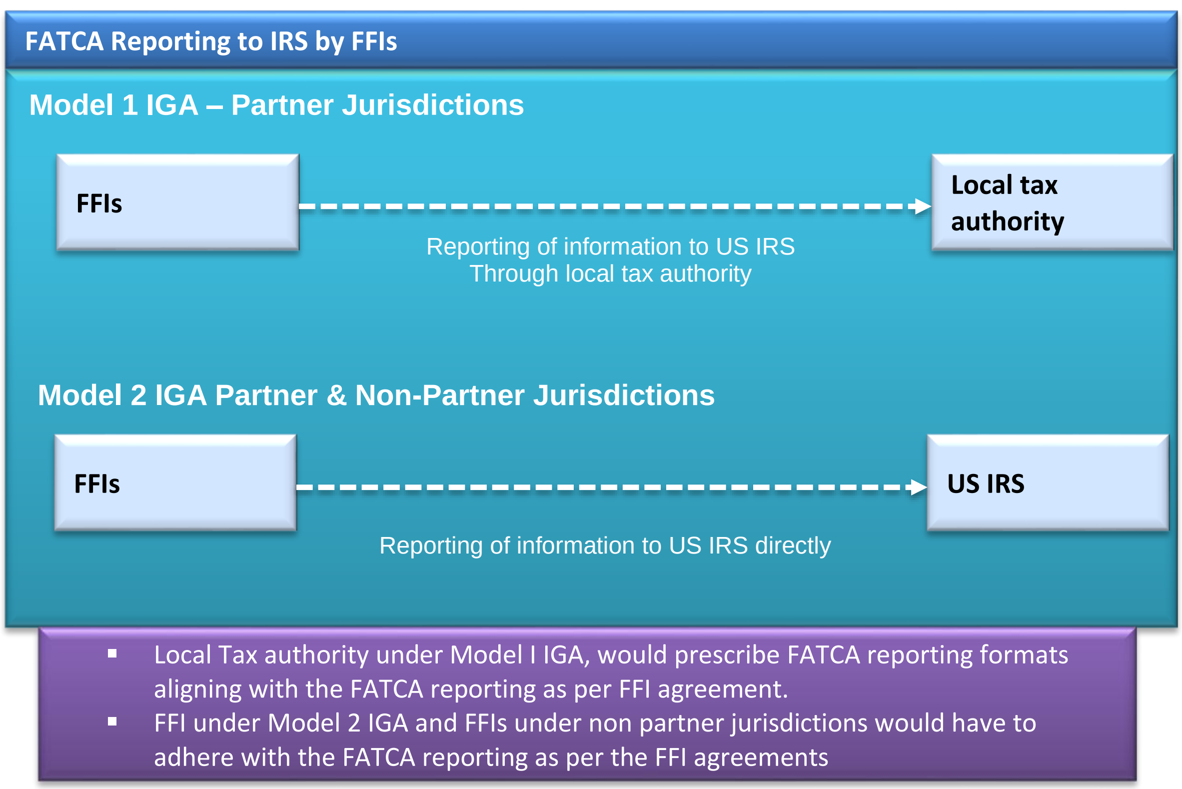
7. FATCA reporting

By Financial Institutions located in Non IGA partner jurisdiction Countries

Foreign financial institutions (FFIs) operating in jurisdictions where IGAs have not been signed, are required to enter into agreements with the IRS directly and report information about financial accounts held by U.S. taxpayers or held by foreign entities in which U.S. taxpayers hold an ownership interest directly to the IRS, or face punitive U.S. withholding tax on U.S.-source payments.

By Financial Institutions located in IGA partner jurisdiction countries

Financial institution operating in justification where IGAs have been signed, are required to report on FATCA compliance as per the IGA signed as under;



Information required to be reported to IRS

Financial institutions operating whether under IGA jurisdiction or not, are required to report the following information to IRS

Info. No.	Information to be reported
1	Account holder's name & for passive non-financial foreign entity, name(s) of any substantial U.S. owners
2	Account holder's U.S. TIN & for passive non-financial foreign entity, only the TIN(s) of any substantial U.S. owner(s)
3	Account holder's address for passive non-financial foreign entity, only the address(es) of substantial U.S. owner(s)
4	Account number
5	Account balance or value
6	For accounts held by recalcitrant/non consenting account holders, report aggregate number and balance or value
7	Income paid (except certain gross proceeds from the sale or redemption of property)
8	Gross proceeds paid to custodial accounts

For Year	Info. No. to be reported
2015	1-6
2016	1-7
2017	1-8
2017 Onwards	1-8

8. IGA Model signing status

Jurisdictions that have signed agreements

IGA Model	Number of Countries*
1	25
2	5
Total	30

Jurisdictions that have reached agreements in substance and have consented to being included on the list of IGA

IGA Mode l	Number of Countries*
1	30
2	0
Total	30

* List of countries provided in appendix 1.

9. Conclusion

FATCA is a US-centric law that has wide extraterritorial application and has become contentious globally because of its broad application, the burdens and costs that it will impose on FFIs and NFFEs, and its conflict with local laws

Model IGA approach to FATCA compliance is intended to eliminate local law conflicts and enable FFIs to comply with FATCA by gathering and reporting the information required under FATCA to their local tax authorities, as mandated by local law.

A conclusion can be drawn from the analysis of the main regulations under FATCA and the Model IGA approach that in the broader context, the model IGA

- Establishes a framework for countries to obtain financial information from other countries on an automatic exchange of information basis (pursuant to an agreement to exchange information).
- Simplifies the situation in the sense that a FATCA Partner FFI would not expect any withholding arising on account of FATCA to the extent it complies with its own legal obligations in the FATCA partner jurisdiction pursuant to the IGA and the regulations.

Also a critical evaluation of the two IGA Models indicates that they differ significantly in their approaches to FATCA implementation and a potential FATCA Partner jurisdiction would have to evaluate its own priorities along with the benefits and burdens of each model while deciding on any of the models.

Appendix 1

Jurisdictions that have signed agreements

Model 1 IGA

Sr. No.	Country	Date signed
1	Canada	5-Feb-14
2	Costa Rica	26-Nov-13
3	Cayman Islands	29-Nov-13
4	Denmark	19-Nov-12
5	Finland	5-Mar-14
6	France	14-Nov-13
7	Germany	31-May-13
8	Guernsey	13-Dec-13
9	Honduras	31-Mar-14
10	Hungary	4-Feb-14
11	Ireland	23-Jan-13
12	Isle of Man	13-Dec-13
13	Italy	10-Jan-14
14	Jersey	13-Dec-13
15	Luxembourg	28-Mar-14
16	Malta	16-Dec-13
17	Mauritius	27-Dec-13
18	Mexico	19-Nov-12
19	Netherlands	18-Dec-13
20	Norway	15-Apr-13
21	Spain	14-May-13
22	United Kingdom	12-Sep-12
23	Australia	28-Apr-14
24	Belgium	23-Apr-14
25	Estonia	11-Apr-14

Model 2 IGA

Sr. No.	Country	Date signed
1	Bermuda	19-Dec-13
2	Chile	5-Mar-14
3	Japan	11-Jun-13
4	Switzerland	14-Feb-13
5	Austria	29-Apr-2014

Jurisdictions that reached agreements in substance and consented to being included on the list of IGA signed effective from the date mentioned below

Model 1 IGA

Sr. No.	Country	Date signed
1	Bahamas	17-Apr-14
2	Bulgaria	23-Apr-14
3	Brazil	2-Apr-14
4	British Virgin Islands	2-Apr-14
5	Croatia	2-Apr-14
6	Columbia	23-Apr-14
7	Curaçao	30-Apr-14
8	Czech Republic	2-Apr-14
9	Cyprus	22-Apr-14
10	Gibraltar	2-Apr-14
11	India	11-Apr-14
12	Israel	28-Apr-14
13	Jamaica	2-Apr-14
14	Kosovo	2-Apr-14
15	Kuwait	1-May-14
16	Latvia	2-Apr-14
17	Liechtenstein	2-Apr-14
18	Lithuania	2-Apr-14
19	New Zealand	2-Apr-14
20	Panama	1-May-14
21	Peru	1-May-14
22	Poland	2-Apr-14
23	Portugal	2-Apr-14
24	Qatar	2-Apr-14
25	Slovak Republic	11-Apr-14
26	Slovenia	2-Apr-14
27	South Africa	2-Apr-14
28	South Korea	2-Apr-14
29	Sweden	24-Apr-14
30	Romania	2-Apr-14

About Author(s)

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Sources: *http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-FATCA*