Briefing

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Private Client and Wealth Structuring

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It's a FATCA world...

FATCA. These five letters do not refer to *Federación Argentina de Trabajadores Cerveceros y Afines* (The Argentinian Federation of Brewers and Allied Workers). For many trust professionals, life would be easier (or at least more entertaining) if they did.

Instead, FATCA (the Foreign Account Tax Compliance Act) is a US law which seeks to encourage information reporting on accounts and investments held by US citizens outside the US. It is due to come into effect this year, and is likely to have wide-ranging implications for taxpayers around the world, not just US citizens.

This is partly because other jurisdictions are using the FATCA model to facilitate automatic information reporting between tax authorities. Many European and other jurisdictions (including the UK) are keen to use this as another means of fighting tax avoidance.

On a practical level, those affected by FATCA will need to have appropriate due diligence and compliance procedures in place by 1 July 2014 (and register with the IRS as appropriate).

Background to FATCA

FATCA was enacted in the US with the aim of preventing tax avoidance by US citizens who hold investments overseas. The intention is to make non-US financial institutions report on US account-holders. As the US cannot enforce this directly, compliance is encouraged by the threat of a 30% withholding tax imposed on certain payments to financial institutions which are not FATCA-compliant.

In order words, non-US financial institutions are given a choice. Either they become compliant, which involves registering with the IRS and reporting on US account-holders, or they risk being subject to a 30% withholding tax on payments with a US source or connection. (FATCA-compliant institutions would also be involved in imposing this withholding tax on certain payments made to non-compliant financial institutions.)

Compliance concerns

Many non-US financial institutions would not be able to comply with the US rules without breaching data protection, confidentiality or other laws in their local jurisdictions. This issue has largely been resolved, at least for financial institutions in jurisdictions which have entered into an intergovernmental agreement ("**IGA**") with the US.

Intergovernmental agreements

The IGA framework envisages that financial institutions will be required by local law to report on US account holders, either to the local tax authorities which will then pass on the information to the IRS ("**model 1**") or direct to the IRS ("**model 2**"). Registration with the IRS is still required.

All financial institutions in the relevant jurisdiction are then deemed to be compliant with FATCA. This means they should not suffer FATCA withholding tax. Nor are they required to impose the withholding tax on payments they make. (It is still possible for financial institutions to become non-FATCA compliant, but this requires significant failure which is not remedied over a 12 or 18 month period.)

A considerable number of jurisdictions have entered into model 1 IGAs with the US (including the UK, France, Germany, Ireland, Italy, Spain, as well as the Cayman Islands, Guernsey, Jersey and the Isle of Man). A handful of jurisdictions (so far only Bermuda, Chile, Japan and Switzerland) have entered into model 2 IGAs. Many of the model 1 IGAs are reciprocal (including the US-UK agreement) which means that US financial institutions should also be required to report on accounts held by relevant non-US citizens.

What does this mean?

For financial institutions in an IGA jurisdiction, the threat of FATCA withholding tax should have receded. The focus, instead, is on status and compliance.

Establishing an institution's FATCA status is the first, key step. Generally, only financial institutions are required to register and report under FATCA.

However, "financial institution" does not just mean banks and deposit-takers. The term is widely defined and can include brokers, custodial banks, various types of investment funds and collective investment schemes, investment managers and trust companies - and even certain types of trusts and partnerships, which are treated as entities for FATCA purposes. For example, a trust may be a financial institution if it has a company appointed as trustee or manager. Even if an entity does qualify as a financial institution, there are certain exemptions from registration and reporting that may also apply. Trusts, for example, can be exempted from the registration or reporting requirements in certain cases (depending, for example, on whether another entity such as a corporate trustee itself satisfies the necessary reporting requirements).

An entity (including a trust) which is not a financial institution is not required to register or report but may still have to consider

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its FATCA status. This is because entities which are treated as "passive" non-financial foreign entities ("**passive NFFEs**") are required to provide information about any controlling US interests to financial institutions (which will then report that information).

What do FATCA financial institutions have to do?

If an entity is a "financial institution" (and no exemption applies) it will generally have to register with the IRS. In the case of model 1 IGA financial institutions, the 25 April 2014 registration deadline has effectively been deferred to 25 October 2014 (although early registration is generally advisable). A financial institution must also carry out relevant due diligence on its financial accounts and report accordingly.

In the case of UK resident financial institutions (and UK branches of non-resident financial institutions) this means carrying out due diligence and reporting to HM Revenue & Customs ("**HMRC**") under UK regulations. The first report for the 2014 financial year (on accounts held on 30 June 2014 or opened thereafter) has to be made to HMRC by 31 May 2015. HMRC has published extensive guidance (which may be found **here**) which explains in greater detail what needs to be done. This guidance is due to be updated again in August 2014.

Even if a UK financial institution has no US account-holders, no US assets or other US connection, it is still required to register with the IRS and report (even if this is a nil return).

Another point to watch out for is that, if a financial institution has subsidiaries or branches in a number of different jurisdictions, this can mean having to comply in each relevant jurisdiction.

There remain areas of uncertainty. For example, in the context of trusts, working out whether or not a trust is a financial institution in the first place is not always that easy. In the UK, professional bodies have provided helpful supplemental guidance on this area (including a flowchart and examples which may be found at **www.step.org/fatca**).

The FATCA revolution

FATCA has evolved beyond its US origins. Various countries and supra-national bodies, including the G8, the G20, the EU and the OECD, have recognised the merits of an automatic exchange of information system. The OECD has recently published the final text of its Common Reporting Standard (which may be found **here**) for automatic exchange of information between tax authorities. The OECD's model agreement is based on the FATCA IGAs (with a few differences). Over 40 jurisdictions have committed to early adoption of this Common Reporting Standard.

In the meantime, the UK has entered into agreements with its Crown Dependencies (the Isle of Man, Guernsey and Jersey) and Overseas Territories (the Cayman Islands, Gibraltar, Montserrat, Bermuda, the Turks and Caicos Islands, the British Virgin Islands and Anguilla) (together "**CDOT**") which will lead to FATCA-style information reporting. As well as UK guidance on the CDOT agreements (including differences from FATCA) (which may be found **here**), Guernsey, Jersey and the Isle of Man have also published joint draft guidance (which may be found **here**) for financial institutions in those jurisdictions dealing both with FATCA and the agreements with the UK (including, at section 7, guidance on the treatment of Crown Dependency resident trusts).

These developments mean that FATCA-style reporting will not be limited to US accounts.

Conclusion

The world of FATCA is here.

The first step for any entity, including a trust, is to determine its FATCA status. Is it a financial institution? Does any exemption apply? Or is it a passive NFFE? Entities that are financial institutions with reporting obligations (which have not already done so) will need to ensure that they have registered in time with the IRS and that they have the necessary compliance and reporting procedures in place. Due diligence will need to be carried out on accounts held at 30 June 2014 (and new accounts thereafter).

And that is just US FATCA. Similar information reporting will be required in respect of other international agreements as well. Argentinian beer is not, unfortunately, the answer.

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