FATCA: An Overview

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How Did We Get Here?

- The Internal Revenue Service (IRS) believes U.S. persons are significantly underreporting income contained in offshore bank accounts
- Approximately $7.8 trillion is held in offshore bank accounts and the loss to the IRS could be as much as $100 billion a year
- UBS case – key case leading to the introduction of FATCA
  - In 2009 the U.S. Senate Permanent Subcommittee on Investigations discovered that there were 52,000 U.S. persons with tax-evading bank accounts at UBS
  - The U.S. Department of Justice demanded the names of U.S. account holders
  - UBS agreed to pay a $780 million fine and give the IRS the names of a small percentage of the U.S. account holders
  - UBS closed the offending accounts and promised to notify the IRS of any new accounts opened for U.S. persons

Timeline of FATCA Implementation

- The Foreign Account Tax Compliance Act (FATCA) was passed in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act
- The IRS issued Proposed Regulations in Feb 2012, followed by Final Regulations in Jan 2013
- As part of the implementation process, the U.S. has signed Inter-Governmental Agreements with the U.K., Denmark, Ireland, Mexico, and Switzerland
  - Some of the agreements are mutual (e.g. UK) while others are non-mutual (e.g. Switzerland)
  - U.S. is in discussion with other countries to implement similar agreements
- Start date for FACTA compliance has been pushed back to July 1, 2014

FATCA Summary

FATCA compliance requirements:

- Applies to Foreign Financial Institutions (FFIs), defined as non-U.S. entities that:
  - Are engaged in banking or similar business;
  - Hold financial assets for others as a substantial part of their business;
  - Are in the business of investing or trading securities or partnership interests; or
  - Are engaged in certain insurance businesses
- FFIs have three options under FATCA:
  - (1) Enter into an agreement with the IRS and become a participating FFI
    - IRS will assign the FFI a Global Intermediary Identification Number (GIIN)
    - FFI must maintain a compliance program sufficient to provide the IRS the required information
  - (2) Do nothing and suffer a 30% withholding on U.S. source interest and dividends and proceeds on the sale of U.S. securities
    - Withholding will not be reduced by any applicable treaty rate (Reg. § 1.1474-2(a)(5))
  - (3) Comply with the terms of an Inter-Governmental Agreement (IGA) (if available)

FATCA Summary

FATCA compliance requirements (cont.):

- Information that must be reported by FFIs (Reg. § 1.1471-4(d)(3)):
  - Name, address, and taxpayer identification number;
  - Account number and balance; and
  - Payments of interest during the calendar year
- U.S. taxpayers must complete Form 8938 listing their foreign accounts
  - This will be compared to the information received from FFIs

FATCA Summary

Inter-Governmental Agreements:

- U.S. has three model agreements used as a base for negotiations:
  - Model IA – reciprocal agreement whereby both countries agree to annually share information. Under this model, the FFIs do not need to report to the IRS directly because the home government does that on their behalf
    - E.g. the U.S.-U.K. IGA. Under this agreement, U.K. financial institutions will need to report information concerning U.S. account holders to the U.K. government and U.S. banks will need to do the same for U.K. residents. The information will then be passed directly between the U.S. and the U.K.
  - Model IB – nonreciprocal agreement whereby the other country will collect information on U.S. accounts in that country and send it to the U.S. on an annual basis
    - No IGAs of this type yet enacted
  - Model 2 – permits FFIs in that country to send information to the IRS under the FATCA rules without the risk of violating domestic law
    - E.g. U.S.-Switzerland IGA
- FFIs based in a country that has signed a Model IA or Model IB IGA with the U.S. do not need to enter into an agreement with the IRS to obtain a GIIN
  - The FFIs will need to ensure the information is made available to the domestic government

Comparison to FBAR Rules

- The Report of Foreign Bank and Financial Accounts (FBAR) requires U.S. persons to report foreign accounts if, on aggregate, those accounts contain more than $10,000 at any point during the year
- FATCA also requires U.S. persons to report information to the IRS (Form 8938) and there are concerns that this is duplicative and may cause confusion where there are differences in the terms adopted (e.g. slight difference in definition of U.S. persons, U.S. territory, etc)
- Key comparisons between FATCA and FBAR filings for U.S. persons:
  - Reporting limit: FATCA = $50,000, FBAR = $10,000
    - May be higher depending on residence, marital status, etc
  - Filing Deadline: FATCA = with tax return, FBAR = June 30
  - Who has to file?: both rules apply generally to U.S. citizens and resident aliens. FBAR rules apply to domestic entities while FATCA does not, however the IRS anticipates issuing regulations to include such entities
  - Penalties: FATCA = $10,000 plus up to 40% of underpaid tax, FBAR = $10,000 but up to $100,000 (or 50% of account balance if higher) for willful failure to file
- Lots of duplication and taxpayers are required to file both forms, even if the same information is on each

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