Initial Guidance on the US Foreign Account Tax Compliance Act

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The Hiring Incentives to Restore Employment (HIRE) Act of 2010, which became US law on 18 March, largely incorporates the legislation previously circulated as the Foreign Account Tax Compliance Act (the FATCA provisions). The FATCA provisions force non-US financial institutions to provide the US Department of the Treasury (the Treasury) with information sufficient to establish which accounts are held by US persons, or suffer 30 per cent withholding on US-source payments to those accounts.

Guidance on the FATCA provisions was released on 27 August 2010 in Notice 2010-60 (the Notice), which describes how non-US financial institutions are to comply with these new information reporting requirements and how US payors to non-US entities are to comply with the corresponding new withholding, documentation and reporting obligations.

The FATCA provisions will be effective for payments made after 31 December 2012, although payments on "obligations" that were outstanding as of 18 March 2012 will be exempted from the new regime. The Notice provides that the term "obligations", for this purpose, does not include any instrument treated as equity for US tax purposes or any legal agreement that lacks a definitive expiration or term (*i.e.*, savings deposits, demand deposits or brokerage or custodial accounts). The Treasury intends to issue regulations providing that any significant modifications to grandfathered obligations within the meaning of regulation Section 1.1001-3 will result in the obligation being treated as newly issued for purposes of the FATCA provisions.

> "The Notice provides helpful preliminary guidance."

Definitions and Examples

The FATCA provisions define "foreign financial institution" as any non-US entity that: 1) accepts deposits in the ordinary course of a banking or similar business, 2) holds financial assets for the account of others as a substantial portion of its business, or 3) is engaged in the business of

investing or trading in securities, partnership interests or commodities, or interests in the same. The Notice provides that the Treasury intends to issue regulations on each of these three categories, and in the interim provides examples of each. Illustrative examples of entities described in each respective category are: 1) savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies and other cooperative banking institutions; 2) broker-dealers, clearing organisations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans; and 3) mutual funds, funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles. Importantly, the Notice states explicitly that a trust company will be considered a foreign financial institution. The Notice further states that "a small family trust settled and funded by a single person for the sole benefit of his or her children" could be categorised as a foreign financial institution, although goes on to provide that the Treasury is considering adopting a less burdensome reporting regime for such "small" foreign financial institutions.

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Foreign Financial Institution Compliance

The FATCA provisions require a foreign financial institution to enter into a Foreign Financial Institution (FFI) Agreement to avoid 30 per cent withholding on payments from US payors. The Treasury has yet to publish a draft, but under such an agreement the foreign financial institution would undertake to obtain and report information regarding each holder of each of its accounts in accordance with due diligence procedures prescribed by the Treasury. Further, it would agree to withhold on payments to non-participating foreign financial institutions and to account holders who fail to provide the information necessary to determine whether they are US persons. Pursuant to an FFI Agreement, the foreign financial institution would undertake to obtain and report: i) the name, address and taxpayer identification number of each US account holder that is not otherwise exempted from the FATCA provisions; ii) for accounts held by non-US entities, the name, address and taxpayer identification number of each US person that has a 10 per cent interest in such entity; iii) the account number; iv) the account balance and value; v) the gross receipts and gross withdrawals or payments from the account; and vi) such other account-related information as the Internal Revenue Service (IRS) may request.

The Notice describes the procedures to be applied by participating financial institutions to make the determinations required to comply with the FATCA provisions. The FATCA provisions only apply to accounts with an average month-end balance of US$50,000 or more. A foreign financial institution will be able to rely on any W-9s it has collected with respect to such accounts and so treat them as US accounts. For all other existing accounts, the foreign financial institution shall mine its "electronically searchable information" associated with the account for "indicia of potential US status", which the Notice describes as: a) identification of any account holder as a US resident or US citizen, b) a US address, c) a US place of birth for the account holder, d) an "in care of" or "hold mail" address, e) a power of attorney or signature authority granted to a person with a US address, or f) standing instructions to transfer funds to an account maintained in the United States, or directions received from a US address.

If the foreign financial institution finds any such indicia of potential US status, it is then to obtain either IRS Form W-9 from the account holder to establish US status or IRS Form W-8BEN to establish non-US status, as the case may be. Account holders who do not provide the information requested will be subject to 30 per cent withholding. The foreign financial institution will have one year from the effective date of its FFI Agreement to search its databases and make the requisite information requests of its account holders.

The Notice creates analytically distinct categories for accounts opened by individuals after the effective date of an FFI Agreement, but the procedures are essentially the same as for pre-existing accounts. The FFI will gather W-9s or otherwise examine the information collected in connection with opening the new account, and will likewise categorise the account as a US or non-US account based on the presence or absence of the same "indicia of potential US status" described above (however, without regard to whether the account information is held in "electronically searchable files"), unless the account holder provides documentary evidence to the contrary. Similarly, the procedures for accounts held by entities, opened before and after the effective date of an FFI Agreement, closely mirror the procedures for individual accounts.

As non-US financial institutions, trusts and other entities prepare for the new FATCA reporting and withholding regime that becomes effective as of 1 January 2013, the Notice provides helpful preliminary guidance as to the scope of diligence that will be required of non-US financial institutions in order to identify US accounts if withholding on payments of US source income is to be avoided. It will be interesting to see whether the FATCA provisions achieve their intended result of greater transparency and cross-border information sharing, or instead trigger a degree of capital flight from the United States and deepen the growing reluctance of certain non-US financial institutions to maintain accounts on behalf of US clients.

More information on the FATCA provisions is available at www.mwe.com/info/news/wp0410b.pdf.

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