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The Model Intergovernmental Agreement Under FATCA

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Introduction

The Foreign Account Tax Compliance Act ("FATCA")[1] imposes a 30% U.S. withholding tax on certain payments to a foreign financial institution ("FFI"), including interest paid by a U.S. borrower, if the FFI does not agree to disclose information about its U.S. accountholders to the U.S. government. Under proposed regulations (the "Proposed Regulations"), withholding does not apply to payments on obligations outstanding on January 1, 2013, and FATCA withholding generally begins on January 1, 2014. Final FATCA regulations are expected this fall.

On February 8, 2012, the U.S. Treasury released a joint statement with the governments of France, Germany, Italy, Spain and the United Kingdom (the "participating countries"). The statement recognised that implementing FATCA could be complicated by several issues, including the existence of local legal restrictions on information reporting (such as privacy considerations), as well as compliance costs for FFIs. The statement announced that the participating countries would develop a framework for "domestic reporting and reciprocal automatic exchange based on existing bilateral treaties" that would address the local legal restrictions and reduce compliance costs for FFIs.

Model Intergovernmental Agreement

On July 26, 2012, the U.S. Treasury released a model intergovernmental agreement (the "Model Agreement") to implement FATCA that was developed in consultation with the participating countries. On the same day, the U.S. and the participating countries issued a Joint Communiqué stating that the parties look forward to a speedy conclusion of bilateral agreements based on the Model Agreement, including by other jurisdictions. The parties also state that they will, in cooperation with other countries, work towards common standards to support a more global system of combating tax evasion while minimising compliance burdens.

The Model Agreement likewise commits the parties to working with the OECD to adapt the Model Agreement to a common model for automatic information exchange.

The Model Agreement creates an alternative to the usual rule that an FFI is exempt from FATCA withholding tax only if it enters into a direct agreement with the U.S. Internal Revenue Service ("IRS") to provide information about U.S. accountholders. Rather, an FFI located in a jurisdiction that has entered into the Model Agreement (such jurisdiction, the "FATCA Partner") would provide the relevant information to the FATCA Partner, and the FATCA Partner would itself provide the information to the IRS. An FFI branch located within the FATCA Partner would be subject to the Model Agreement even if the FFI's place of incorporation or headquarters was located elsewhere.

The participating countries published two versions of the Model Agreement. Under the nonreciprocal agreement, information would only flow from the FATCA Partner to the IRS. Under the reciprocal agreement, the U.S. would also provide the FATCA Partner with information about the FATCA Partner's taxpayers that are accountholders of U.S. financial institutions. The U.S. will only enter into the reciprocal agreement if it is confident that the information will remain confidential and will only be used for tax purposes.

The Model Agreement (in both versions) requires the U.S. and the FATCA Partner to automatically share information pursuant to a bilateral tax treaty or tax information exchange agreement between the two nations.

Consequently, the Model Agreement would only be available for jurisdictions that have such a treaty or agreement with the U.S. In addition, the FATCA Partner would, if necessary, be required to adopt local legislation allowing the relevant information to be provided by the FFI to the FATCA Partner and then to the U.S.

The Model Agreement requires the FATCA Partner to obtain from all of its nonexempt FFIs, and provide to the U.S., the name and identifying number of the FFI, and, for each financial account in the FFI held by a U.S. person (or by a non-U.S. person that has a controlling U.S. person), (i) the name, address and U.S. taxpayer identification number ("TIN") of the U.S. person, (ii) the account number, (iii) the account balance or value and (iv) the amount of interest, dividends and other income credited to the account. The Model Agreement imposes extremely detailed "due diligence" requirements on an FFI in determining whether its accountholders are U.S. persons. The reciprocal agreement requires the U.S. to provide similar information to the FATCA Partner, and this requirement could increase the burden on U.S. financial institutions (such as to obtain a foreign TIN from non-U.S. depositors).

Under FATCA and the Proposed Regulations, if an FFI cannot obtain information about an account holder or cannot provide such information to the IRS because of local laws, the account holder is treated as "recalcitrant" and is subject to withholding by the FFI or termination of the account. These rules would not apply under the Model Agreement as long as the U.S. receives the required information (for example, if the FATCA Partner is able to obtain the information from the FFI or the holder).

Similarly, under FATCA and the Proposed Regulations, an FFI entering into a private agreement with the IRS is in compliance only if its "expanded affiliated group" enters into similar agreements. The FFI must terminate its business in any jurisdiction in which its branch or affiliate cannot enter into such an agreement.

By contrast, under the Model Agreement, an FFI will be treated as compliant notwithstanding the status of its expanded affiliated group, if the FFI and the branch or affiliate satisfy certain conditions, including anti-abuse rules.

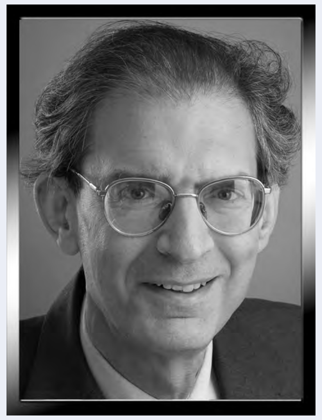
The Model Agreement does not exempt FATCA Partner FFIs from FATCA. Rather, a FATCA Partner FFI that complies with its obligations under the Model Agreement will be deemed to have complied with FATCA and accordingly will not be subject to FATCA withholding. If a FATCA Partner FFI is in significant noncompliance with its obligations, the FATCA Partner is obligated to apply its local laws (including penalties) to obtain compliance, and if this is not successful within 18 months, the FFI will be added to an IRS list of noncompliant FFIs that are subject to FATCA withholding tax.

The Model Agreement clarifies and simplifies the obligations of FFIs and has received a generally favorable response in the U.S.

The Future

The U.S. Treasury has stated that it hopes that agreements will be signed with the participating countries by early September. It will then begin negotiations with other countries. In addition, in June 2012, the Treasury issued separate Joint Statements with Switzerland and Japan that contemplated a different framework (the so-called Model II approach). Under that approach, FFIs in the relevant jurisdiction would provide certain information directly to the U.S., and such information would be supplemented by exchange of information between the U.S. and the other government pursuant to a group request under the treaty or other agreement. The Treasury is expected to release a model agreement containing this alternative in the near future.

One complexity created by the Model Agreement is that some branches of an FFI could be subject to the Model Agreement, while other branches could be subject to different rules in individual agreements with the IRS. Hopefully, the final FATCA regulations will provide rules similar to those in the Model Agreement. This would greatly simplify compliance with FATCA by all FFIs, especially those located in multiple jurisdictions.



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1 - Internal Revenue Code sections 1471-1474.