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Treasury Releases Model Agreement for an Alternative FATCA Framework

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The authors examine the model agreement recently released by the Treasury Department for information sharing between governments under the Foreign Account Tax Compliance Act.

The U.S. Treasury Department recently released two versions of a model agreement ("Model Agreement") for information sharing between governments under the Foreign Account Tax Compliance Act ("FATCA"). The Model Agreement offers an alternate and fairly straightforward framework for the implementation of FATCA that many foreign entities that will be impacted by FATCA are likely to view as a welcome development.

BACKGROUND

FATCA, which was included in the Hiring Incentives to Restore Employment Act of 2010, is part of an ongoing effort to combat offshore tax evasion by U.S. persons. FATCA establishes a withholding and reporting system that requires foreign financial institutions ("FFIs") (typically foreign banks and foreign hedge and private equity funds) to report certain information regarding U.S. ownership of foreign accounts and foreign entities to the Internal Revenue Service ("I.R.S.") or be subject to a 30 percent withholding tax on all payments the FFI receives of certain U.S. source income (including

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interest, dividends, and gross proceeds from sale of property). To avoid this withholding tax, the FFI must be a so-called "participating FFI" and enter into an agreement with the I.R.S. (an "FFI Agreement") that requires the FFI to provide the relevant information regarding the U.S. accounts to the I.R.S. FATCA also requires certain nonfinancial foreign entities ("NFFEs") to report certain information to the I.R.S. regarding payees. If the NFFE does not report such information, certain payments made to the NFFE on behalf of the beneficial owner will also be subject to 30-percent withholding.

FATCA has been supplemented by guidance issued by the Treasury Department and the I.R.S., including proposed regulations (the "Proposed Regulations") that were released last February. If published in final form, the Proposed Regulations would provide significant relief to entities affected by FATCA. Simultaneously with the release of the Proposed Regulations, the Treasury Department announced in a joint statement with France, Germany, Italy, Spain and the United Kingdom (the "Joint Statement") that it had agreed with these European governments to negotiate an alternative framework to fulfill the purpose of FATCA while relaxing its compliance burdens.[1] Following the Joint Statement, the Treasury Department developed the Model Agreement in consultation with these countries. The Model Agreement is an important development in that it represents joint efforts to combat offshore tax evasion. In addition, the countries have agreed to work with other partner countries and the Organization for Economic Co-operation and Development on adapting the Model Agreement to a common model for automatic exchange of information, including establishing reporting and due diligence standards to combat tax evasion with fewer compliance costs and burdensome requirements. The five countries and the U.S. endorsed the Model Agreement and called for the speedy adoption of bilateral agreements based on the Model Agreement.

THE MODEL AGREEMENT

The Model Agreement eliminates the obligation that each FFI enter into a separate FFI Agreement with the I.R.S. in order for such FFI to be compliant with FATCA. Instead, if a foreign country enters into an agreement with the U.S. based on the Model Agreement, FFIs residing in such foreign country would be required to provide the necessary information regarding U.S. accounts to their government, which in turn would exchange such information with the I.R.S. on an automatic basis every year. FFIs that meet the information reporting obligations laid out in the Model Agreement would be treated as complying with FATCA. An annex attached to the Model Agreement (Annex I) provides detailed procedures to be followed in order to meet the due diligence obligations for identifying and reporting on U.S. accounts of individuals and entities.

The Model Agreement was released in two versions, a reciprocal version and a non-reciprocal version.[2] Based on the Treasury Department's news release, the reciprocal version will be used in countries with which the U.S. has an income tax treaty or tax information exchange agreement, and with respect to which the Treasury Department and the I.R.S. have determined that such country has sufficient measures in place to ensure that the information is kept confidential and is used only for tax purposes. Such determination will be made on a case-by-case basis. If the U.S. and a partner country enter into a reciprocal version of the Model Agreement, the I.R.S. will be required to provide its partner country with information on accounts held by residents of such country in U.S. financial institutions. The non-reciprocal version does not require the I.R.S. to provide such information.[3]

Some key provisions of the Model Agreement include the following:

- *Information Reporting and Timing*. Similar to the phase-in of information reporting approach in the Proposed Regulations, in 2013 and 2014, partner countries would only be required to exchange U.S. persons' identifying information and account balances. Beginning in 2015, in addition to providing the identifying information of U.S. persons, partner countries would be required to report the income generated from property held in such accounts, and would begin reporting gross proceeds from the sale or redemption of property in 2016. The Model Agreement generally provides for the exchange of the necessary information within nine months after the end of the calendar year to which the information relates.
- *Entities "Deemed Compliant" with FATCA*. The Model Agreement treats as deemed compliant, and therefore not subject to FATCA, certain retire-

ment plans and other FFIs that pose a low risk of tax evasion. Such entities would be identified by the U.S. and its partner country in a separate annex to the agreement.

- *Recalcitrant Account Holders*. FATCA requires an FFI that is unable to obtain and report the necessary information on U.S. accounts (for example, because domestic laws restrict such reporting), to treat the account holder as "recalcitrant," thereby subjecting the account to withholding and closure. The Model Agreement suspends these rules so long as the I.R.S. receives the necessary information from the partner country.
- *Affiliated Groups*. Under the general FATCA rules, every FFI in an expanded affiliated group must be a participating FFI or deemed a compliant FFI in order for one of its members to enter into an FFI Agreement. If published in final form, the Proposed Regulations would create a two-year transitional period, through December 31, 2015, during which the existence of an FFI affiliate in a restrictive jurisdiction that prohibits the FFI's compliance with the information reporting and withholding obligations under FATCA will not prevent the other FFIs in the same group from entering into an FFI Agreement, provided that the FFI in such restrictive jurisdiction agrees to perform due diligence to identify its U.S. accounts and meet certain other requirements. The Model Agreement modifies these rules by treating an FFI from a partner country as deemed compliant or exempt from FATCA after the end of the two-year transition period if certain requirements are met, notwithstanding that a member of its group is not a participating or deemed compliant FFI. Such FFI would be obligated to treat its member as a non-participating FFI for purposes of FATCA, and such non-participating member would be required to identify its U.S. accounts and meet the information reporting obligations of FATCA to the extent permitted under the laws of the restrictive jurisdiction.
- *Due Diligence Requirements for Preexisting Accounts*. Annex I eases the due diligence procedures described in FATCA for both individual and entity account holders in a manner that is generally consistent with the approach taken in the Proposed Regulations and sets *de minimis* thresholds below those for which no review and reporting is required. Preexisting individual accounts with a balance or value of US$50,000 or less[4] as

of December 31, 2013 are not required to be identified or reported. An electronic search will suffice for accounts with a balance or value that exceeds the US$50,000 threshold but is under US$1,000,000. Increased due diligence, including a potential review of paper records, will only be required when a preexisting individual account balance or value exceeds US$1,000,000. Preexisting entity accounts that have an account balance or value that exceeds US$250,000 as of December 31, 2013, and accounts in which the balance does not exceed US$250,000 as of December 31, 2013 but later exceeds US$1,000,000, must be reviewed and reported only if held by one or more entities that are U.S. persons, or certain NFFEs controlled by one or more U.S. citizen or resident.

- *Due Diligence Requirements for New Accounts*. The *de minimis* threshold for new individual accounts opened on or after January 1, 2014 is US$50,000. For new individual accounts that are not exempt from the review and reporting requirements, the FFI must obtain from the account holder a self-certification that allows the FFI to determine whether the account holder is resident in the U.S. for tax purposes. The FFI may rely on information collected by it in connection with opening the account, including any documentation collected under existing anti-money laundering/"know your customer" rules. For new entity accounts opened on or after January 1, 2014, the FFI would be required to determine whether such account holder falls into one of the categories enumerated in Annex I. Such determination may be based on publicly available information or, if not available, a self-certification from the account holder. The FFI would determine its review and reporting obligations after making the determination with respect to each account holder.

WHAT NEXT?

According to media press releases, a senior official of the Treasury Department has indicated that the Treasury Department hopes to conclude agreements with France, Germany, Italy, Spain, and the United Kingdom by early September. The official also noted that the Treasury Department will cooperate with other countries that are interested in signing bilateral agreements based on the Model Agreement.

According to joint statements released in June between the U.S. and Japan and Switzerland, the Treasury Department is cooperating with those two countries to develop an alternative model agreement for FATCA implementation.[5] The joint statements contemplate a structure of direct reporting from the FFIs to the I.R.S., supplemented, upon request by the U.S. competent authority, by the exchange of information on U.S. accounts that are identified as accounts of recalcitrant account holders. The Treasury Department hopes to release the model agreement reflecting this second alternative framework in September.

NOTES

[1] The Joint Statement is available at: http://www.treasury.gov/press-center/press-releases/documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

[2] The reciprocal version is available at: http://www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf. The non-reciprocal version is available at: http://www.treasury.gov/press-center/press-releases/Documents/nonreciprocal.pdf.

[3] We note that both versions of the Model Agreement assume that the partner country has entered into an income tax treaty or tax information exchange agreement with the U.S. This suggests that the alternative framework would not be available to countries with which the U.S. does not have an income tax treaty or tax information exchange agreement. However, based on statements of senior I.R.S. officials, it appears that an alternative framework may nevertheless be available for such non-treaty countries. If the U.S. ultimately negotiates alternative framework agreements with such non-treaty countries, we expect the negotiations to be based on the non-reciprocal version. In addition, it appears that the existence of an income tax treaty or tax exchange information agreement will not be sufficient to permit a country to enter into the reciprocal version of the Model Agreement unless the I.R.S. is confident that the partner country has the requisite confidentiality safeguards in place.

[4] For preexisting individual accounts that are insurance and annuity contracts, the threshold is increased to US$250,000.

[5] The joint statement with Japan is available at: http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Japan.pdf. The joint statement with Switzerland is available at: http://www.treasury.gov/press-center/press-releases/Documents/FATCA%20Joint%20Statement%20US-Switzerland.pdf.