# FATCA Compliance for Investment Managers

Terence Coppinger, Director, Deloitte Tax LLP
Kip Cawley, Associate, Foley Hoag LLP

Operational Risk Breakfast Club
Boston, Massachusetts
April 4, 2012

**Confidential Draft – For Discussion Purposes Only**

## What is FATCA?

- "Foreign Account Tax Compliance Act" sections of the HIRE Act of 2010.

## Why was FATCA enacted?

- To prevent U.S. taxpayers from evading U.S. tax by hiding financial assets in offshore accounts.

## How does FATCA work?

- In general, any payor of U.S.-source FDAP income (interest, dividends, rents, royalties, etc.) or gross proceeds from the sale of U.S. securities must withhold 30% from such amounts paid to a non-U.S. entity unless the non-U.S. entity agrees to comply with certain due diligence, reporting and withholding obligations.

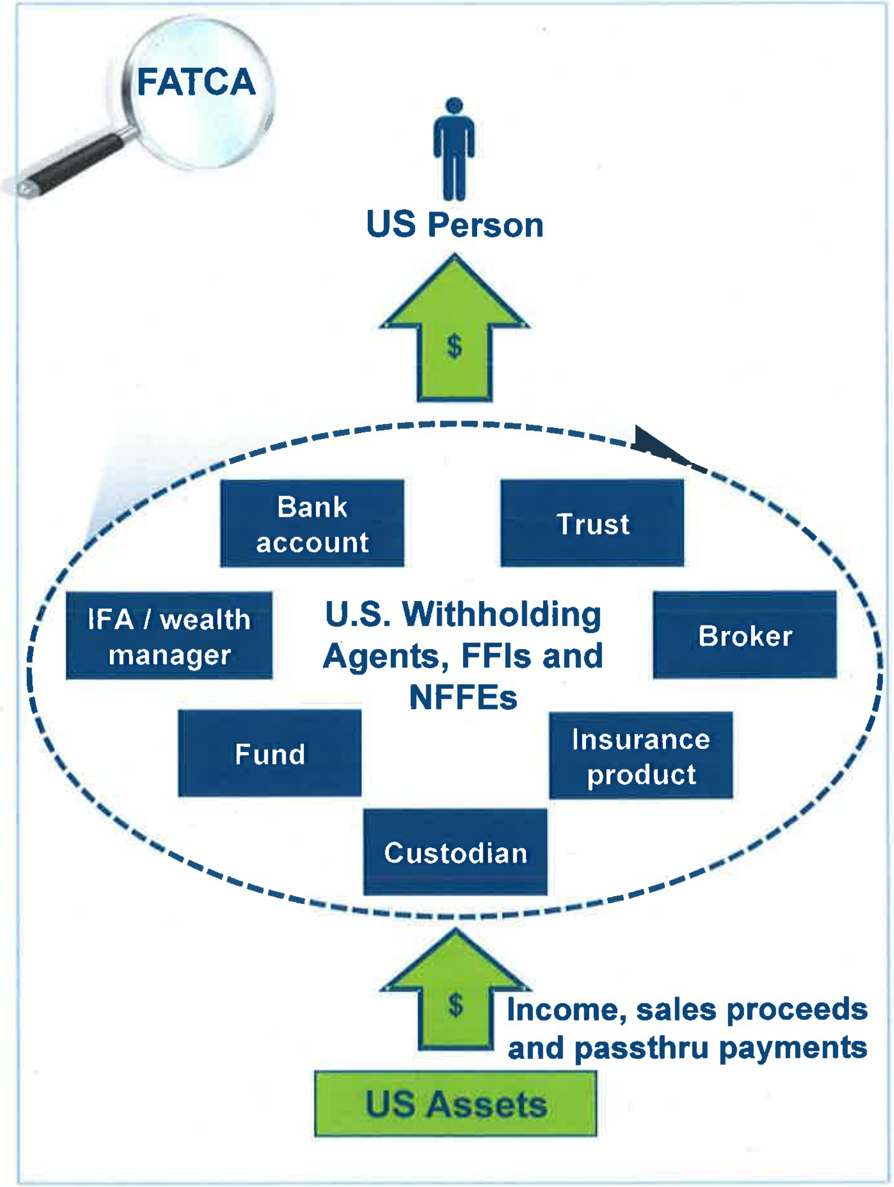
# Key Players

| | |
|---|---|
| Foreign Financial Institutions (FFIs) | A non-U.S. entity that (1) accepts deposits; (2) as a substantial part of its business, holds financial assets for the account of others; or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing or trading securities, partnership interests, commodities or any interests (including futures, forward contracts or options) in such positions. |
| Non-Financial Foreign Entities (NFFEs) | A non-U.S. entity that is not an FFI or an exempted entity. |
| U.S. Withholding Agents | U.S. person that has control, receipt, custody, disposal or payment of any "withholdable payment." |
| U.S. Financial Institutions (USFIs) | A U.S. entity that (1) accepts deposits; (2) as a substantial part of its business, holds financial assets for the account of others; or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing or trading securities, partnership interests, commodities or any interests (including futures, forward contracts or options) in such positions. |
| U.S. Individuals | U.S. citizens, U.S. residents and non-resident aliens who are physically present in the United States for at least183 days during the current year and the previous two years (applying a fractional rate). |

# Other Defined Terms

| | |
|---|---|
| Withholdable Payments | 1/1/14 – U.S.-source interest, dividends, rents, royalties, insurance premiums and other fixed or determinable annual or periodical gains, profits and income (FDAP Income).<br><br>1/1/15 – FDAP Income and gross proceeds from the sale or other disposition of U.S. debt or equity securities.<br><br>1/1/17 – FDAP Income, gross proceeds and Foreign Passthru Payments. |
| Passthru Payments | Withholdable payments, and payments attributable to withholdable payments, made by one FFI to another FFI. |
| Substantial U.S. Owner | A U.S. person that owns, directly or indirectly, more than 10% of the stock (corporation) or profits/capital interests (partnership) of a foreign entity. |
| Deemed-Compliant FFI | FFIs that are determined, through a separate registration and certification process, not to pose a significant risk of tax avoidance. |
| FFI Agreement | Agreement between an FFI and the IRS regarding due diligence, reporting and withholding obligations under FATCA. |
| Participating FFI (PFFI) | An FFI that enters into and complies with the terms of an FFI Agreement. |
| Non-Participating FFI (NPFFI) | An FFI that does not enter into an FFI Agreement. |
| Recalcitrant Holder | NPFFI or other person that does not provide required information to a withholding agent. |

# FATCA aims to lift the veil from U.S. persons trying to avoid U.S. tax obligations by holding assets in non-U.S. structures and products




## What does FATCA involve?

- FFIs are required to enter into FFI Agreements with U.S. Treasury to identify and report U.S. accounts annually.
- NFFEs are required to report Substantial U.S. Owners or certify no U.S. ownership.
- U.S. withholding agents and PFFIs are required to withhold 30% of withholdable payments made to recalcitrant holders or NPFFIs.
- PFFIs are required to select Responsible Officers who certify that the FFI is in compliance with the obligations set forth under the FFI Agreement.

## Who must meet the FATCA requirements?

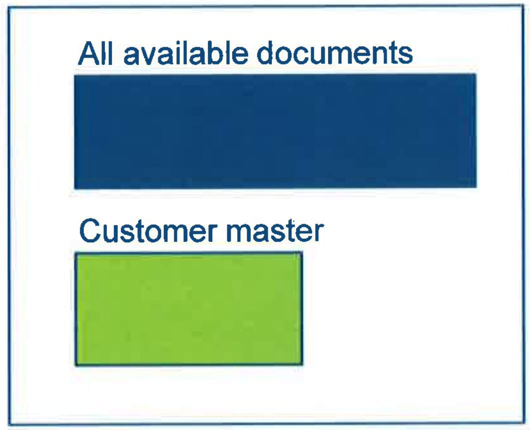
- FFIs
- NFFEs and affiliates
- U.S. Withholding Agents

## Who are the targets?

- U.S. Individuals
- U.S. Entities (including corporations, partnerships and trusts)
- NFFEs with Substantial U.S. Owners

# Release of proposed regulations on February 8, 2012 had some impacts, but major focus areas remain

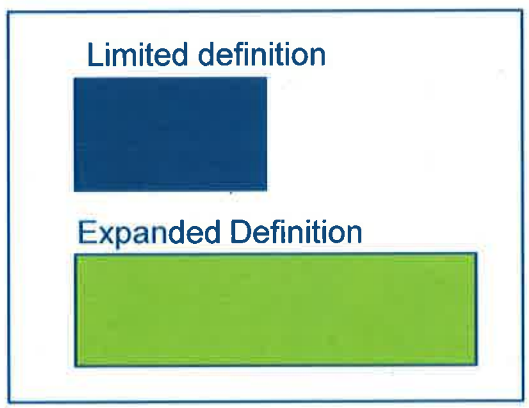

**Threshold for high net worth individual accounts**




**Documentation for high net worth individuals**


**Threshold for individual insurance contracts**


**Threshold for entity accounts**




**Deemed compliant criteria**

# Myths vs. Realities

| FATCA Myths | FATCA Realities |
| --- | --- |
| Impact of FATCA will be pervasive and will require financial institutions to make extensive changes for all legal entities and lines of business | Impact of FATCA varies significantly by type of business and legal entity, and financial institutions can employ "fencing strategies" to limit operational impact while remaining fully compliant |
| FATCA will require the implementation of new core IT systems or a major redesign of existing core systems | IT solutions can be architected to implement FATCA without extensive changes to core systems |
| FATCA implementation will set ongoing AML/KYC initiatives off-track since there are significant new requirements | FATCA requirements are incremental to AML/KYC and they can be folded into current initiatives without resetting timelines |
| Financial institutions cannot rely on third-party service providers for ongoing FATCA compliance without undertaking prohibitive oversight | Service providers have powerful incentives for complying with FATCA and verifying their compliance will be similar to verifying their compliance capabilities for existing information requirements |

# What are the Key Requirements?

| | |
|---|---|
| Registration | ▪ The IRS has stated that PFFIs or deemed-compliant FFIs should register online with the IRS before June 30, 2013 to avoid withholding from January 1, 2014. |
| Remediation | ▪ FFIs will need to search electronic information on pre-existing accounts maintained or executed by the withholding agent as of January 1, 2013, or executed by the FFI prior to the effective date of the FFI Agreement. |
| Withholding | ▪ FATCA withholding begins on certain payments to (1) NPFFIs, and (2) NFFEs with recalcitrant Substantial U.S. Owners, beginning on January 1, 2014, subject to a phase-in schedule: income (2014); gross proceeds (2015). Withholding on foreign passthru payments will not begin before 2017. |
| Reporting | ▪ FATCA reporting will be phased-in between 2014 (for tax year 2013) and 2017 (for tax year 2016). |
| Client On-Boarding | ▪ The proposed regulations generally do not require an FFI to make significant modifications to the information collected on customer intake, and existing KYC processes can generally be used, except in specific cases. |

# Registration

- Early-2012: Draft Model FFI Agreement to be published by the IRS
- Late-2012: Final Model FFI Agreement to be published by the IRS
- January 1, 2013: On-line FFI registration process begins
- June 30, 2013: Recommended deadline for on-time FATCA compliance as of the January 1, 2014 FATCA withholding start date

# Remediation

| | Existing Individual "U.S. Accounts" | Existing Entity "U.S. Accounts" |
|---|---|---|
| **Exempt from Review** | Account Value ≤ $50k | Account Value < $250k, and then until the value exceeds $1M |
| **Electronic Search* Only** | Account Value > $50k-$1M | |
| **Electronic AND Non-Electronic Searches* Required** | Account Value > $1M | |
| **AML/KYC Records** | | All Other Accounts<br>• <u>Passive Investment Entities (Value > $1M)</u>: Information regarding all "Substantial U.S. Owners" in addition to AML/KYC information |

* Searches are for "U.S. Indicia": (1) identification of an account holder as a U.S. person; (2) a U.S. place of birth; (3) a U.S. address; (4) a U.S. telephone number; (5) standing instructions to transfer funds to an account maintained in the United States; (6) a power of attorney granted to a person with a U.S. address; or (7) a U.S. "in-care-of" or "hold mail" address that is the sole address the FFI has identified for the account holder.

# Withholding

| | 2014 | 2015-2016 | 2017-on |
|---|---|---|---|
| U.S.-Source<br>• Interest<br>• Dividends<br>• Rents<br>• Royalties<br>• Insurance Premiums<br>• Other Fixed or Determinable Annual or Periodical Gains, Profits and Income | ✓ | ✓ | ✓ |
| Gross proceeds from the disposition of property that produces U.S.-source dividends and interest | | ✓ | ✓ |
| Foreign Passthru Payments | | | ✓ |

# Reporting

| | 2014 (for TY 2013) – 2015 (for TY 2014) | 2016 (for TY 2015) | 2017 (for TY 2016)-on |
|---|---|---|---|
| • Name<br>• Address<br>• Taxpayer I.D. Number<br>• Account No. (if any)<br>• Account Balance/Value | ✓ | ✓ | ✓ |
| • Income Credited to the Account | | ✓ | ✓ |
| • Gross Proceeds | | | ✓ |

- Reporting may be done in U.S. or local currency
- 2014 Reporting (for TY 2013) is due September 30, 2014
- All subsequent reporting will be due on March 31st

# Ongoing Certification

- Each FFI must designate a "Responsible Officer."
- The Responsible Officer must provide the IRS with periodic certifications that the FFI has complied with its FFI Agreement.
- The FFI Agreement will not require a PFFI to undergo periodic external audits.

# What This Means for You

## General USFI Requirements

- Identify all account holders that are foreign entities;
- Determine FATCA taxonomy status (e.g. FFI, NFFE) of foreign entity accounts;
- Obtain required documentation and certifications from foreign entity accounts;
- Maintain scanned documents associated with each account to support the decisions made; and
- Establish a process for FATCA withholding and reporting for non-compliant foreign entity accounts (non-participating FFIs and NFFEs that do not provide appropriate certification).

## General FFI Requirements

- Obtain information to determine which account holders and beneficiaries are U.S. accounts;
- Comply with verification and due diligence procedures on such accounts as required by the IRS;
- Report information regarding "specified" U.S. accounts to the IRS on an annual basis (where foreign law would prevent such reporting, obtain a waiver, and if unable to obtain a waiver, close the account);
- Deduct and withhold the 30% tax on payments to recalcitrant account holders, non-compliant NFFEs, electing FFIs, and FFIs that did not enter into an FFI agreement with the IRS; and
- Comply with requests from the IRS for any additional information.

# Potential Roles by Market Participant

**Fund Managers**

- Update fund offering and subscription documents to identify FATCA requirements and outline their FATCA compliance program
- Maintain valid and current FFI agreements with U.S. Department of Treasury and provide status to counterparties
- Implement policies and procedures, or oversee service providers, in documenting investors as U.S. or Non-U.S., and performing the KYC, AML, and FATCA reviews of their investors (FATCA reviews may be required annually)

**Fund Administrator**

- Verify that all operating policies, procedures, and technology platforms are capable of supporting the new FATCA requirements
- Work with Investment Managers and Hedge Fund clients to identify and perform KYC, AML and FATCA reviews in an ongoing manner
- Monitor U.S. asset percentages of funds to assist in the reporting of passthru payment percentages for their clients, and posting to regulatory agencies if necessary
- Perform the necessary withholding calculations and submit required liability to the U.S. Department of Treasury

**Custodian & Prime Broker**

- Maintain client's FFI status, and withhold appropriately for non-compliant clients on U.S. sourced gross sale proceeds and all U.S. sourced dividend and interest payments, swap payments, and other income or profits received
- Define policies and procedures for documenting instructions received from a fund and/or their service providers for processing outflows of cash, and withholding amounts when necessary

## Key Preparation Activities

- **Education**: Conduct education sessions across the organization, to begin making cross functional staff aware of potential impacts to their operations and infrastructure.
- **Communication**: Develop a communication plan for notifying customers about FATCA and the impact of FATCA compliance.
- **Identification/Registration**: Identify FFI funds, products, or entities within your organizational model and begin the registration process.
- **Service Providers**: Perform preliminary due diligence reviews of external service providers such as fund accountants, custodians, transfer agents, and distributors.
- **Due Diligence/Remediation**: Compare existing customer data to proposed FATCA requirements and identify any necessary remediation activities or potential enhancements to customer on-boarding programs.
- **Infrastructure**: Review current technology and reporting infrastructure to identify potential upgrades or enhancements necessary for compliance with FATCA's withholding and reporting requirements.

# When Does it Become Effective?

| 2012 | | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Proposed FATCA Regulations | Model FFI Agreement | FATCA Becomes Effective | FATCA Withholding and Reporting | | | |

Feb. 8, 2012
FATCA proposed regulations released

Early 2012
Draft Model FFI Agreement

Fall of 2012
Release Final Model FFI Agreement

January 1, 2013
- Online Process for registering Participating or Deemed Compliant FFIs
- Initiate enhanced due diligence processes to determine U.S. indicia
- Outstanding obligations as of 1/1/2013 considered out of scope for withholding

July 1, 2013
FFI Agreements executed prior to 6-30-2013 will have a 7-1-2013 effective date, and will be ensured to have the assigned FFI number published in time to prevent FATCA FFI withholding on 1-1-2014 (unless otherwise elected).

**January 1, 2014**
**FATCA withholding on Income payments**

**Sept. 30, 2014**
**FFIs report on Name, Address, TIN, Account number and Account Balance of U.S. accounts**

**January 1, 2015**
**FATCA withholding on income payments and Gross Proceeds.**

**March 31, 2016**
**FFIs report on Name, Address, TIN, Account number and Account Balance as well as income payments on U.S. accounts**

**January 1, 2017**
**Earliest date to apply withholding on Passthru Payments**

**March 31, 2017**
**FFIs report on Name, Address, TIN, Account number and Account Balance of U.S. accounts as well as income payments and Gross Proceeds on U.S. accounts**

# Questions?

## Contact Information for Follow Up Questions:

**Terence Coppinger**
**Deloitte Tax LLP**
tcoppinger@deloitte.com
Office Phone: (212) 436-6412
Cell Phone: (516) 639-1634
www.deloitte.com

**Kip Cawley***
**Foley Hoag LLP**
kcawley@foleyhoag.com
Phone: (617) 832-1189
www.foleyhoag.com

* Admitted in Pennsylvania Only