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Here They Come: First FATCA Intergovernmental Agreement Signed

Background

In July of this year, Treasury released a model intergovernmental agreement (IGA) that offered a work-around to foreign entities whose countries of residence have laws preventing the entities from complying directly with FATCA and reflected a cooperative intergovernmental approach to tackling international tax evasion. Under the reciprocal and nonreciprocal versions of the model IGA ("Model I"), in exchange for FATCA reporting to the local foreign government (with subsequent automatic exchange with the United States) and certain other reporting of payments made to nonparticipating foreign financial institutions (FFIs), an FFI would be relieved of certain requirements, such as entering an FFI agreement with the IRS, having tax withheld on payments to the FFI, withholding on payments to nonparticipating FFIs (unless the FFI acts as a Qualified Intermediary), withholding on or closing accounts of "recalcitrant" account holders and withholding on pass-thru payments or gross proceeds.

The U.S./UK Agreement

On September 14, 2012, Treasury announced that the United States and the United Kingdom had signed the first Model I IGA. In general, the U.S./UK IGA closely tracks the model, reflecting a liberalization of rules in the Proposed Regulations. The U.S./UK IGA is a reciprocal agreement, meaning the United States will report on UK residents who have accounts with U.S. financial institutions. FATCA reporting to the UK government will be subject to automatic exchange of information under Art. 27 of the U.S./UK income tax treaty. Information must be exchanged within nine months after the relevant calendar year except that, with respect to 2013, the information may be exchanged by September 30, 2015.

The agreement covers all resident UK financial institutions (excluding branches outside of the United Kingdom) and branches of non-UK financial institutions located in the United Kingdom. "Financial institutions" include Custodial Institutions (entities holding a substantial portion of their assets for the account of others), Depository Institutions (entities accepting deposits in the ordinary course of a banking business), Investment Entities (entities conducting as a business, on behalf of a customer, securities/money market investment tracking or portfolio management of funds) and Specified Insurance Companies (generally, insurance companies issuing or making payments with respect to cash value insurance contracts or annuity contracts).

Other aspects of the U.S./UK IGA include the following:

1. Information regarding accounts held by U.S. persons and foreign entities controlled by U.S. persons that UK financial institutions must report to the UK government (for exchange with the United States) is as follows:
 - a. name, address, ID number, account number, account balance or value—commencing with respect to the years 2013 and 2014;
 - b. in addition to (a) above, in the case of a Custodial Account, the total gross amount of interest, dividends and other income paid to an account; in the case of a Depository Account, the total gross amount of interest paid to the account; and, in the case of all other accounts, the total gross amount paid to that account with respect to which the UK financial institution is the obligor or debtor—commencing with respect to the year 2015; and
 - c. in addition to (a) and (b) above, gross proceeds from the sale or redemption of property paid to an account with respect to which the UK financial institution acts as custodian, broker, nominee or agent for the accountholder—commencing with respect to the year 2016.

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2. Under the agreement, a UK financial institution will not be subject to § 1471 withholding if it:
 - a. timely identifies and reports U.S. accounts to the UK government;
 - b. for 2015 and 2016, reports the name of each non-participating FFI to which it has made payments (and the amount thereof) to the UK government;
 - c. complies with relevant registration requirements;
 - d. withholds 30 percent of U.S. Source Withholdable Payments (which excludes gross proceeds) if the institution assumes primary withholding liability as a Qualified Intermediary; and
 - e. in the case of a UK financial institution not described in (d), which makes a payment to a nonparticipating FFI or acts as an intermediary with respect to such payment, it provides the immediate payor with information required for withholding and reporting with respect to such payment.
3. UK financial institutions need not withhold with respect to accounts held by recalcitrant accountholders or close such accounts, provided that the UK financial institution provides the required information on such accounts.
4. UK financial institutions are not required to withhold on gross proceeds or pass-thru payments (although the parties have agreed to develop alternative approaches to achieve these policy goals).
5. With respect to related entities or branches of a UK financial institution that operate in jurisdictions that prevent them from becoming a participating or deemed-compliant FFI, the status of the UK financial institution as a deemed compliant foreign financial institution may continue indefinitely, provided that (a) the UK financial institution treats such related entities or branches as nonparticipating FFIs with respect to the IGA's reporting and withholding requirements (and the related entity or branch holds itself out as such to withholding agents), (b) the related entity or branch identifies U.S. accounts and reports under FATCA to the extent legally permissible in its country, (c) the related entity or branch does not solicit U.S. accounts held by persons that are not resident in its jurisdiction or accounts held by nonparticipating FFIs that are not established in that jurisdiction and (d) the UK financial institution does not use the related branch or entity to circumvent obligations under FATCA or the IGA.
6. The U.S./UK IGA has a "most favored nation" clause pursuant to which the UK is to be granted the benefit of any more favorable terms under the IGA.
7. Annex I provides the due diligence procedures for identifying and reporting on U.S. reportable accounts and payments to nonparticipating FFIs with respect to pre-existing (defined as existing as of December 31, 2013) and new individual and entity accounts.
8. Annex II, the more heavily negotiated annex, contains a list of beneficial owners (e.g., UK and international governmental entities and certain retirement funds), deemed compliant financial institutions (e.g., not-for-profit entities or financial institutions with a local client base meeting certain requirements), and exempt products (e.g., certain retirement accounts or products), which are effectively exempt from FATCA.

Conclusion

The U.S./UK IGA's similarity to the Model I IGA released in July reflects the IRS' goal to limit by-country customization of these agreements (other than items contained in Annex II of the model). This standardized approach should relieve financial institutions' burden to comply with widely varying IGA rules across countries, although the IRS has acknowledged difficulties that institutions will face if they are FATCA partner country residents with operations in non-IGA jurisdictions. Without more, such institutions would be governed by both an IGA and the soon to be finalized regulations. Final FATCA regulations, expected later this fall along with a proposed FFI Agreement, may comprise IGA principles, but will surely have differences. As the FATCA effective date approaches, we can expect more IGAs to be signed, although IGA-implementing legislation in the respective FATCA partner countries will take time. For example, the UK released a "Consultation Document" (Sept. 18, 2012) requesting UK comments on the terms of U.S./UK IGA, subsequent to which legislation will be introduced in 2013. In contrast, the U.S. considers IGAs executive agreements that do not require ratification by Congress. These agreements certainly represent a step forward in FATCA implementation and guidance as compared to one year ago.

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