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**Jack Cummings**  
*Editor*

*The Atlantic Building*  
*950 F Street, NW*  
*Washington, D.C. 20004-1404*  
*202.239.3300*  
*Fax: 202.239.3333*

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## The FATCA Model 2 Intergovernmental Agreement

### *Background*

In late July, the Treasury released a Model 1 Intergovernmental Agreement (IGA) to facilitate foreign financial institutions' (FFIs) compliance with FATCA reporting rules. The Model 1 IGA generally requires FFIs to report information directly to their respective government, which then automatically exchanges the information with the United States pursuant to an income tax treaty or exchange of information agreement. Around the time the Model 1 IGA was released, the Treasury Department issued separate joint statements with Switzerland and Japan regarding another cooperative framework to implement FATCA, as an alternative to the Model 1 IGA. On November 15, 2012, the IRS released the Model 2 IGA, previously agreed to in principle by Switzerland and Japan. The Model 2 IGA generally calls for direct reporting by FFIs to the IRS (unlike the Model 1 IGA), supplemented with aggregate disclosure of recalcitrant accountholder data pursuant to exchange of information requests by the IRS.

The key elements in the Swiss joint statement would have Switzerland direct its financial institutions to conclude FFI agreements with the IRS, enable these FFIs to comply with FATCA reporting and honor IRS requests for additional information about accounts identified as "recalcitrant" and reported by the FFIs on an aggregate basis. Compliant or exempt FFIs would not be required to terminate accounts of recalcitrant accountholders or to impose pass-thru payment withholding on payments to recalcitrant accountholders or other financial institutions in Switzerland or any country with a FATCA IGA in place. The joint statement with Japan was similar except that Japan would not direct its financial institutions to enter FFI agreements with the IRS, but rather direct them to "register" with the IRS and confirm their intention to comply with official guidance issued by Japan consistent with the obligations of FFIs under FATCA.

### *The Model 2 Agreement*

The Model 2 IGA combines some elements of the Swiss and Japanese joint statements with the United States, but not others. For example, the Model 2 IGA does not require FATCA partner financial institutions to enter FFI agreements, as provided in the joint statement with Switzerland. As contemplated by the joint statement with Japan, the Model 2 IGA provides that financial institutions will be directed to "register" with the IRS and enabled to comply with the requirements of FATCA, including due diligence, reporting and withholding. Significantly, the Model 2 IGA does not restrict compliance to guidance issued by the foreign government that is consistent with FATCA, as the joint statement with Japan considered. Assuming registration and compliance pursuant to a Model 2 IGA, an FFI would be treated as FATCA compliant and not subject to withholding.

Under the Model 2 IGA, an FFI must request the U.S. taxpayer identification number (TIN) for accountholders of preexisting accounts identified as "U.S. Accounts" and obtain consent to report that information to the IRS. An FFI must inform the accountholders that, if consent is not obtained, (i) information with respect to such accounts (referred to in the Model 2 IGA as "Non-Consenting U.S. Accounts") will be reported to the IRS on an aggregate basis; and (ii) the IRS may subsequently request specific information about the accounts, which the FFI would be required to report to its respective government for exchange with the IRS. A similar procedure applies to accounts of nonparticipating

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financial institutions with respect to foreign reportable amounts. New accounts either identified as U.S. Accounts or of nonparticipating financial institutions may be opened only on the condition that the accountholder consents to the FFI providing required information to the IRS. (With some variation, the due diligence obligations set forth in Annex I of the Model 2 IGA are largely similar to those in Annex I of the Model 1 IGA.)

The IRS will be able to make “group requests” to the FATCA partner based on the aggregate information reported by an FFI and the standards set forth in an exchange of information agreement. The FATCA partner then has six months to provide the requested information in the same format as it would be reported if the FFI had reported directly to the IRS. If the response is delayed for some reason, the FFI must treat the relevant accounts as recalcitrant and withhold under FATCA, starting on the date of the six-month deadline and ending on the date that the information is exchanged with the IRS. If the foreign government cooperates timely with IRS information requests, compliant FFIs would not be required to withhold tax on or close recalcitrant accounts.

The Model 2 IGA also addresses retirement plans established in and regulated by or located in the FATCA partner jurisdiction and identified in Annex II by treating them as exempt beneficial owners, deemed compliant FFIs or exempt products, as the case may be. Generally, Annex II lists a given country’s exempt beneficial owners (e.g., governmental entities, retirement funds), certain exempt products (e.g., retirement accounts and other tax favored products) and deemed compliant FFIs (i.e., small financial institutions with a local client base and certain collective investment vehicles).

The Model 2 IGA shares a number of similar provisions to the Model 1 IGA. For example, under the IGAs, if certain conditions are met, an FFI can be treated as participating or deemed compliant even if it has a related entity or branch in a country that would otherwise prevent it from being compliant. The Model 2 IGA also grants the FATCA partner “most favored nation” status with respect to other jurisdictions, as provided in the Model 1 IGA recently signed with the United Kingdom. The Model 2 IGA similarly contemplates the parties’ shared commitment to finding an approach to achieve policy objectives of foreign pass-thru payment and gross proceeds withholding and, if the FATCA partner so seeks, reciprocal information collection and exchange by the United States with respect to FATCA partner accountholders.

## *Conclusion*

As alternatives to the soon-to-be-released final FATCA regulations, both model IGAs share certain features, but there are some differences. For example, the Model 2 IGA adopts a different role for foreign governments as compared to the Model 1 IGA. Under the Model 1 IGA, a foreign government effectively serves as an intermediary to the supply of information from FFIs to the United States. The Model 2 IGA only involves a foreign government directly in exchange of information requests (and directing and enabling its financial institutions to comply with FATCA). Some FFIs may prefer the Model 1 IGA, as it does not require FFIs to enter agreements with the IRS or to report directly to the United States, but that model places greater administrative burden on the foreign government. Therefore, foreign governments may be more inclined to the Model 2 IGA. Another difference is the requirement to obtain consent under the Model 2 IGA. The Model 1 IGA envisions specific account information being reported to a foreign government without the need to obtain accountholder consent, whereas the Model 2 IGA requires consent because the FFI reports information directly to the IRS. Ultimately, though, specific accountholder information would be shared with the IRS, and the only real question is when.

Both the Model 1 and Model 2 IGAs provide some insight into what the final regulations may encompass, although there will likely be significant variations. While the Treasury and IRS have worked hard to offer alternative approaches to the implementation of FATCA, these distinct approaches are likely to create challenges for FFIs operating in different jurisdictions. With more IGAs, of both flavors, being negotiated and signed and the final regulations on the horizon, FFIs should be closely monitoring the various sets of rules that could apply to their operations and establishing the necessary measures to comply.

*For more information, contact Edward Tanenbaum at 212-210-9425 or Heather Ripley at 212-210-9549.*

## **International Tax Group**

Sam K. Kaywood, Jr.  
Co-Chair  
404.881.7481

Edward Tanenbaum  
Co-Chair  
212.210.9425

John F. Baron  
704.444.1434

Henry J. Birnkrant  
202.239.3319

James E. Croker, Jr.  
202.239.3309

Jasper L. Cummings, Jr.  
919.862.2302

Tim L. Fallaw  
404.881.7836

Brian D. Harvel  
404.881.4491

Michelle M. Henkel  
404.881.7633

L. Andrew Immerman  
404.881.7532

Brian E. Lebowitz  
202.239.3394

Clay A. Littlefield  
704.444.1440

Timothy J. Peadar  
404.881.7475

Heather M. Ripley  
212.210.9549