

Global FS Tax Newflash

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FATCA – The new bilateral approach and its implications for financial services

Executive Summary

On February 8, 2012, the U.S. Treasury and the Internal Revenue Service issued proposed regulations that provide details on the provisions contained under the Foreign Account Tax Compliance Act ("FATCA") of 2009, which was enacted as part of the Hiring Incentives to Restore Employment Act of 2010.

Simultaneous to the release of these proposed regulations, a Joint Statement was released by the governments of the United States, France, Germany, Italy, Spain and the United Kingdom ("the FATCA partners") stating that they are exploring a common approach to FATCA implementation through domestic reporting and reciprocal automatic information exchange based on existing bilateral tax treaties ("bilateral agreements").

This is an indication that non U.S. financial institutions (referred to as Foreign Financial Institutions or "FFIs") in these countries will be able to report the information required to be compliant under FATCA to their local government agencies as opposed to the IRS directly. There is however no indication that the information to be reported to a local taxing authority will be materially different from the

information reported under the proposed regulations. Moreover, recent comments from Treasury officials seem to be a clear indication that the account identification and tax information reporting requirements under FATCA will be substantially similar to the requirements under the bilateral agreements. We do not anticipate that this bilateral approach will significantly reduce the burden of FATCA compliance for FFIs. Indeed the bilateral approach may make compliance by FFIs more challenging.

The Proposed Approach: From a one-way street to an open road

The Joint Statement indicates that the FATCA partners “have agreed to explore a common approach to FATCA implementation through domestic reporting and reciprocal automatic exchange based on existing bilateral treaties.”

PwC Observation: The Joint Statement is not a definitive agreement with regard to the common approach for these FATCA partners. Prior to the issuance of the proposed regulations and the Joint Statement, it appeared that FATCA involved the reporting of information from FFIs from all nations to the United States unilaterally.

However this new approach would expand the sharing of information with all participating nations sharing the agreed-upon information with the U.S. in return for similar information from the U.S. to the individual FATCA partners via existing bilateral agreements on an automatic basis. Under this framework, Germany, for instance, will now be expected to share information with the U.S. in return for the automatic reciprocity of certain information from the financial institutions established in the U.S.

At first glance, the proposed approach appears to create a burden on U.S. financial institutions and the U.S. government who must reciprocate to all members entering into a bilateral agreement to share information. However, based on a report by the U.S. Government Accountability Office in September 2011, the United States currently exchanges information automatically with 25 income tax treaty partners. The details of the information to be exchanged are not specified in the treaties and the United States has not signaled an intention to expand on the information currently shared with the FATCA partners. Similar to the shortcomings that the IRS has identified in the Qualified Intermediary regime, the European Union (“EU”) has had similar experiences of its own with the EU Savings Directive, which imposes obligations on EU member states to automatically exchange information between states about individuals who reside in one EU member state, but earn interest in another. Based on the initial feedback on both sides of the Atlantic, it is expected that the FATCA partners

will not allow for the dilution of FATCA under the bilateral agreements and related implementation of local regulations in support of the legislation.

Lastly, the Joint Statement can be viewed to compliment, if not facilitate, the OECD's long standing continuous initiative to improving transparency and information exchange while fighting tax abuse. It is now not inconceivable that FATCA could be the trigger that facilitates the first step to what could eventually become a multilateral approach to information exchange.

Local legislation in FATCA partner countries

The Joint Statement provides a possible framework for an inter-governmental approach in which a non-U.S. FATCA partner would: “Pursue the necessary implementing legislation to require FFIs in its jurisdiction to collect and report to the authorities of the FATCA partner the required information.” The statement goes on to add that FFIs in the FATCA partner would generally “apply the necessary diligence to identify U.S. accounts,”

This proposed framework was cited in the Joint Statement as being necessary to “address legal impediments to compliance, simplify practical implications, reduce FFI costs” and “facilitate enforcement to benefit all parties” aligned with FATCA's objective of “achieving reporting and not to collect withholding tax”. The Statement concludes with the commitment of the FATCA partners to work with additional FATCA partners, the OECD, and, where appropriate, the EU, on adapting FATCA in the medium term to design a common model for automatic exchange of information, including the development of reporting and due diligence standards.

Under the intergovernmental approach, the FATCA partner would agree to:

- a. Pursue the necessary implementing legislation to require FFIs in its jurisdiction to collect and report to the authorities of the FATCA partner the required information;
- b. Enable FFIs established in the FATCA partner to apply the necessary diligence to identify U.S. accounts; and
- c. Transfer to the United States, on an automatic basis, the information reported by the FFI.

PwC Observation: Although the proposed approach would allow each FATCA partner to promulgate different implementation requirements, the intent is to achieve uniformity of reporting and account due diligence requirements for financial institutions in each FATCA partner.

The Joint Statement provides that sufficient due diligence will be required to identify U.S. accounts. From the perspective of either a participating or registered deemed compliant FFI, this signals that the account identification procedures under FATCA will be similar to the procedures promulgated by each FATCA partner. Although the procedures and requirements may be similar, responsibility for enforcement and oversight will shift from U.S. taxing authorities to an appropriate regulatory body in each FATCA partner. Simplification and reduced costs of implementation may be achieved to the extent that FFIs report to their local governments as opposed to reporting to the IRS, but the cost of modifying processes and systems to conform to a FATCA partner's new account identification and reporting requirements remains significant

Benefits to local FFIs in FATCA partner countries

In consideration of the FATCA partner agreeing to the terms and conditions of the inter-government approach, the United States would agree to:

- a. Eliminate the obligation of each FFI established in the FATCA partners to enter into a separate comprehensive FFI agreement directly with the IRS, provided that each FFI is registered with the IRS or is excepted from registration pursuant to the agreement or IRS guidance;
- b. Allow FFIs established in the FATCA partner to comply with their reporting obligations under FATCA by reporting information to the FATCA partner rather than reporting it directly to the IRS;
- c. Eliminate U.S. withholding under FATCA on payments to FFIs established in the FATCA partner (i.e., by identifying all FFIs in the FATCA partner as participating FFIs or deemed-compliant FFIs, as appropriate);
- d. Identify in the bilateral agreement specific categories of FFIs established in the FATCA Partner that would be treated, consistent with IRS guidelines, as deemed compliant or presenting a low risk of tax evasion; and

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- e. Commit to reciprocity with respect to collecting and reporting on an automatic basis to the authorities of the FATCA partner information on the U.S. accounts of residents of the FATCA partner.

PwC Observation: By enacting FATCA's account identification procedures and reporting requirements into the laws of a FATCA partner, it would no longer be necessary for an FFI in a FATCA partner to comply with a comprehensive FFI agreement. FFIs would still be expected to register with the IRS, and if the procedures for registered deemed compliant FFIs are followed, an FFI in a FATCA partner may also be responsible for certain requirements, such as re-registering every three years, etc.

As a result of the agreement with the FATCA partner, FFIs established in FATCA partners to not being required to:

- a. Terminate the account of a recalcitrant account holder;
- b. Impose passthru payment withholding on payments to recalcitrant account holders;
- c. Impose passthru payment withholding on payments to other FFIs organized in the FATCA partner or in another jurisdiction with which the United States has a FATCA implementation agreement

PwC Observation: These provisions would allow FFIs located in FATCA partners to avoid the withholding tax and account closure requirements under FATCA. However, it is unclear as to whether withholding tax would be required under local law. With many FFIs currently assessing the potential impacts of FATCA and seeking solutions to the issue of withholding, consideration is often given to the ability to avoid relationships or transactions which would give rise to excessive withholding tax. It appears that a decision on whether such efforts should cease would be premature.

Although bilateral agreements could eliminate the requirement to impose passthru payment withholding on payments to FFIs established in FATCA partners, it seems FFIs would still be required to compute and perform withholding on passthru payments to nonparticipating FFIs and recalcitrant accountholders located outside of the FATCA partners, potentially even within their own expanded affiliated groups.

An international information exchange model?

The final comments of the Joint Statement indicate a commitment to developing an alternative approach to passthru payment withholding and to work with other nations in adapting FATCA in the “medium-term to a common model for automatic exchange of information, including the development of reporting and due diligence standards.” No agreement has been reached with regard to these final points, but the Joint Statement is indicative of the general commitment among nations to achieve a common approach to achieving the objectives of FATCA.

PwC Observation: It would appear that the FATCA partners clearly intend to implement legislation to achieve the objectives of FATCA while providing some relief to FFIs organized in their jurisdictions by facilitating the reporting of information to the IRS on their behalf. It is expected that other nations will seek to become FATCA partners in the near future, but it remains unclear whether the agreements for these countries will be based on a general framework resulting from the outcome of negotiations with the current FATCA partners, or if individual nations will have the ability to substantially deviate from existing agreements.

Recent comments from the European Commission have indicated a preference for an EU-US agreement on these bilateral agreements, but we understand that this preference would need to be weighed against the time required to pass such legislation and the current timeline for the implementation of FATCA in 2013. Accordingly, it seems unlikely that any resulting agreement would diminish the ability of the IRS and U.S. Treasury to meet the objectives of FATCA. Although efforts have been made through this inter-governmental approach to reduce the burden that FFIs face in identifying, reporting and withholding on certain account holders, the outcome remains to be seen.

Ultimately, the uncertainty and the complexity of potential multilateral agreements will only serve to increase the burden that FFIs face. Therefore, it is crucial that the FATCA partners provide further details of their approach and coordinate efforts, and appreciate that many multinational FFIs have operations and business in current FATCA partners, potential future FATCA partners and non-FATCA partners. Although the efforts now being made by the FATCA partners may ultimately be the basis for further cooperation on the future EU-US exchange of information, this is unlikely to be agreed-upon in the near-term. Treasury officials have stated that the objective of the agreements will be to achieve consistency in the approach by FATCA partners, both those currently in discussion with the U.S. and other countries intending to follow this lead. Any discrepancies, delays or uncertainties in the approach will result in additional complexity and burden for the FFIs and contradict the intended purpose of this inter-governmental approach.

Resources

Included below are links to the guidance released today as well as the press release and the joint statement.

Link to regulations:

The proposed rules are available at:

http://www.ofr.gov/OFRUpload/OFRData/2012-02979_PI.pdf

Link to statement:

<http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf>

Link to release:

<http://www.treasury.gov/press-center/press-releases/Pages/tg1412.aspx>

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