FATCA – business support for a global solution

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The Foreign Account Tax Compliance Act presents business with unique challenges and an opportunity to find global solutions to a single country's broadly-applicable tax legislation, Keith Lawson writes

FATCA – the Foreign Account Tax Compliance Act – presents business with unique challenges and an opportunity to find global solutions to a single country's broadly-applicable tax legislation. The Business and Industry Advisory Committee ('BIAC') to the Organisation for Economic Co-operation and Development is leading the business effort to engage with governments in a mutually beneficial dialogue. The OECD is playing a key role in facilitating these discussions.

The United States enacted FATCA in 2010 to address concerted efforts by certain US taxpayers, sometimes with substantial assistance from non-US financial institutions, to avoid paying taxes owed to the US government. To achieve the US Congress' tax-compliance objectives, FATCA effectively imposes significant customer identification and reporting responsibilities on all non-US financial institutions ('foreign financial institutions' or 'FFIs') with investments in the US. Any FFI that does not comply with FATCA's requirements suffers 30 percent withholding on all payments (including dividends, interest, and sales proceeds) attributable to its US assets.

FATCA, not surprisingly, has generated considerable controversy. The complaints about FATCA include:

(1) the law reflects a unilateral effort by the US to turn foreign institutions into US tax collectors;

(2) some of FATCA's requirements (such as FFIs' obligations to report customer information to the US) cannot be satisfied without an FFI violating the laws (such as data privacy) of the country in which it is organized;

(3) FFIs must incur extraordinary costs to implement FATCA[1]; and

(4) the additional tax revenue collected by the US pales in comparison to the costs imposed on FFIs. Business,

and other governments, raised these and other concerns with the US government early and often, before FATCA's enactment and since.

The US government has responded by engaging actively with business and with other governments. The extensive dialogue has allowed business to explain the myriad of general and industry-specific concerns FATCA presents. Alternative approaches for addressing these concerns have been explored in detail in numerous meetings and ongoing discussions between business and US government officials.

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The preliminary results of this dialogue have been encouraging. The US government issued three documents (in the form of 'IRS Notices') indicating the US government's preliminary thinking on a wide range of issues; each Notice reflected a growing US government appreciation for business' concerns. The FATCA regulations that were proposed in February 2012 continued the positive movement. Among other things, the US government has responded to business' profound concerns that insufficient time exists to comply with FATCA's requirements by delaying many of them.

Even more encouraging was the joint statement that France, Germany, Italy, Spain, the United Kingdom, and the United States issued, on the same day that the proposed FATCA regulations were released, to develop an 'intergovernmental agreement' or 'IGA' to implement FATCA. These six countries also committed to work *"with other partners and the [OECD] . . . on adapting the terms of this Agreement to a common model for automatic exchange of information, including the development of reporting and due diligence standards for financial institutions."* This IGA approach, business quickly concluded, offers a solution to many of FATCA's most intractable problems.

The Model IGA developed by these six countries (known as 'Model 1') was followed by a second model ('Model 2') developed by the United States, Switzerland and Japan. These models simplify many of FATCA's more cumbersome requirements. One significant difference between the models is that FFIs in Model 1 countries report information about US customers to their local governments while FFIs in Model 2 countries report directly to the IRS. The advantage of reporting to local tax authorities is one of the reasons that business generally prefers Model 1.

Business' support for the IGA approach is strong. The IGAs' many benefits include:

- FFIs will be able to comply with FATCA without violating their domestic data privacy laws because the legislation that IGA countries must enact to implement their IGAs expressly will authorize the requisite tax reporting;

- FFIs generally will not be required to impose FATCA withholding on customers whose status as US taxpayers (or not) cannot be determined; and

- substantial market confusion about the 'deemed-compliant' status of retirement plans, retirement accounts, charities, and similar institutions and accounts will be eliminated by Annex II to each IGA – which will list deemed-compliant FFIs.

The movement to making the IGAs a reality has been slow, but steady. The first IGA, with the United Kingdom, was signed in September. A few more have been signed since. The US Treasury announced recently that negotiations are proceeding so well that a total of seventeen IGAs may be signed by the end of 2012. Over 50 countries, US Treasury has announced, have expressed interest in signing an IGA.

For the IGA's benefits to be realized fully, two things must happen. First, the IGA network must be extensive. Second, the IGA negotiated with each country – and each country's implementing legislation – must be as consistent as possible. Without an extensive and consistent IGA network, business will confront too many burdens to implement FATCA in anything approaching a cost-efficient manner.

Perhaps the easiest way to illustrate the problems that business will confront from a sparse IGA network is to consider the reporting responsibilities of a financial services firm with global operations. Almost invariably, the FFI will have its headquarters and/or branches in one or more Model 1 countries. This FFI also most likely will be reporting under Model 2 because Switzerland and a few Asian countries that are important financial centres have indicated a preference for this second Model. Unless IGAs are adopted almost universally, and quickly, it also is quite likely that a global financial services firm will have branches in countries that do not have an IGA. In non-IGA countries, the FFI will be required to apply all of FATCA's requirements (often called 'straight FATCA').

In actuality, the problems of applying three different FATCA methodologies – Model 1, Model 2, and 'straight FATCA' – almost surely will be far more substantial than many suspect. Among other things, no country has enacted (or, as this article is being written, even introduced) FATCA implementing legislation, no country has signed a Model 2 IGA, and the final FATCA regulations have not been issued. Inconsistent requirements, and the delays in receiving clarifications to the ambiguities that surely will arise, are inevitable. Moreover, new issues will emerge as different business units within FFIs study how the detailed rules apply to them.

A global solution is required. If other countries enact their own versions of FATCA, as some have suggested, the need for global consensus will be all the greater. Thankfully, the OECD has emerged as a key driver for an informed multilateral dialogue. The United States, despite the unilateral start to the FATCA debate, is playing a key role as well in developing a consensus on many FATCA issues.

An important step in this global initiative took place in September, when officials from the United States and its five 'joint statement' partner countries provided business with a detailed briefing at the OECD's Paris headquarters. In conjunction with this September meeting, tax officials from OECD member countries met with the FATCA business advisory group organized by BIAC to discuss uniform reporting formats and transmission protocols. The reporting format discussion continued at two subsequent meetings in October and December. While more work needs to be done, the opportunity provided to business to comment on the reporting formats developed by the United States has been most welcome.

The critical next step is a coordinated effort to maximize the consistency between the legislative and regulatory steps that countries take to implement their IGAs. BIAC has urged the OECD to work with its member countries to facilitate a comprehensive discussion with business on these implementation issues. For the process to succeed, however, business must engage fully. The members of the business advisory group come from many regions, countries, industries, and disciplines. This project cannot succeed without active participation by a wide range of industry experts. The potential costs to business of disparate FATCA rules are extraordinary. If FATCA's burdens are to be manageable, business must maintain a knowledgeable and creditable response. ■

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Endnotes

1. These cost include: hiring US tax experts to explain FATCA and assist in building compliance systems; searching existing account records for US persons; modifying account opening procedures to identify US persons; building systems to report account information about US clients; and building systems to withhold on account holders whose status as US or not cannot be determined (so-called "recalcitrant account holders").