

ALLEN & OVERY



The U.S. Foreign Account Tax Compliance Act

Issues and relevant experience

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A brief overview

The U.S. Foreign Account Tax Compliance Act (FATCA) added a new component to the U.S. tax withholding and information reporting regime. The law effectively makes foreign financial institutions (FFIs) information-gathering agents of the U.S. Internal Revenue Service (the IRS) by threatening an FFI's own U.S. source income and sale proceeds with a 30% withholding tax (30% Withholding).

This new regime is not intended to be a revenue-raiser for the U.S. government, but rather to provide a mechanism to identify U.S. investors in FFIs. The 30% Withholding does not apply, for example, if the relevant FFI enters into an agreement with the IRS to report certain information in respect of financial accounts which are held by U.S. persons (as well as certain non-U.S. entities which have a 10% U.S. owner), or complies with prescribed procedures to ensure that the FFI does not maintain financial accounts of such persons or entities.

By entering into such an agreement, an FFI will also oblige itself to apply 30% Withholding to certain payments it makes to other FFIs which have not entered into such agreements.

In 2012, the U.S. published a model intergovernmental agreement (IGA) which provides relief from the withholding rules described above for certain FFIs operating in countries which agree to its terms. Such FFIs will be required to report information about financial accounts to their home country tax authorities, which will in turn transmit it to the IRS.

In September 2012, the UK became the first nation to enter into an IGA with the U.S. In 2013, the UK issued regulations which require UK FFIs to report information to the UK HM Revenue & Customs (HMRC), which information HMRC will transmit to the IRS pursuant to the U.S.-UK IGA. HMRC has also published detailed guidance on the U.S.-UK IGA and the UK regulations. Subsequently, over 20 other jurisdictions have signed IGAs, including Spain, Germany, France, the Netherlands and Italy.

FATCA: who it will affect

The expansive definition of FFI provided by the law means that the FATCA rules are of concern not only to banks, but also to paying agents, investment funds, hedge funds, private equity funds, securitisation vehicles and many other forms of financial intermediary.

The expansive definition of “U.S. source income” means that many transactions which appear to have no U.S. nexus may nevertheless generate income subject to FATCA withholding. For example, certain amounts paid by a non-U.S. company which has elected to be disregarded as an entity separate from its U.S. parent may have a U.S. source for FATCA purposes.

The expansive definition of “account holder” provided by the law means that information may need to be collected not only in respect of customers of banks, but also in respect of holders of some non-publicly traded debt and equity investments in FFIs (eg holders of privately-placed bank debt, equity investors in private equity funds, note holders in securitisation vehicles).

While the IGA network will significantly relieve the impact of FATCA for FFIs in IGA jurisdictions, it does not provide a complete solution and significant challenges remain.



Key issues

Compliance

Although on its face a statute relating to taxation, advice will be required by FFIs to implement the compliance aspects of FATCA. However, compliance is not the only challenge that FFIs face. In particular, FFIs need to review (and, in some cases, amend) existing documentation to ensure that they can carry out their FATCA obligations, and to ensure that they are not subject to financial penalties (eg an obligation to gross up for FATCA withholding).

Contract and commercial

FATCA gives rise to a number of issues which FFIs need to address immediately in the context of transactions into which they are entering today. These include the following:

If the FFI is acting as agent or custodian for another party, does it have the contractual right to withhold, and to gather and report information, as may be required by its agreement with the IRS or an IGA to which it is subject?

Do the transaction documents to which the FFI is a party contain provisions which help identify and minimise potential risks of FATCA withholding on payment streams?

Do the transaction documents to which the FFI is a party properly allocate the risk of FATCA withholding among the parties?

Even if an FFI is itself exempt from FATCA withholding (eg under an IGA), do its transaction documents protect its counterparties from FATCA withholding (eg secondary market purchasers of interests in syndicated loans)?

Regulatory

Compliance with FATCA will give rise to a number of non-tax legal issues which FFIs will need to address, particularly those outside of IGA jurisdictions. These include the following:

Will the disclosure of information about U.S. account holders to the IRS violate agreements between the account holder and the FFI?

Will such disclosure violate data protection or bank secrecy laws in the jurisdiction in which the FFI or the account holder is located?

If an FFI enters into a FATCA agreement with the IRS, will local laws and contractual obligations allow it to apply FATCA withholding to payments it makes to other FFIs?

Will the laws of the FFI's or account holder's jurisdictions permit the closure of an account if the account holder refuses to comply with the information disclosure requirements, as is mandated by FATCA?

These and other legal difficulties are likely to present themselves to FFIs as they attempt to meet the requirements imposed by FATCA. The IGA network is likely to alleviate some of the above difficulties significantly.

How Allen & Overy can help

We have produced a series of training materials on FATCA that we are happy to provide and present without cost in appropriate circumstances. The presentations are designed to give in-house tax, legal and business teams

of banks and other financial institutions an understanding of the issues. They cover steps organisations should be taking now, and outline the negotiating, contractual, regulatory and local law challenges they may face.

The Allen & Overy FATCA team

We have a specialist tax team which is able to advise on all areas of FATCA and its related legal issues, including local law advice regarding the effect of IGAs.

It also includes lawyers in Allen & Overy offices worldwide including specialists in the non-tax regulatory, contract law, and other areas which are essential to FATCA compliance.

They are members of, and advise and participate in, key **FATCA industry groups**, such as:

- participants in the drafting of the FATCA riders published by the Loan Market Association (LMA);
- principal drafters of the International Capital Markets Association letter of comment to the U.S. Congress on the proposed FATCA legislation;
- U.S. and UK FATCA specialists actively engaged in assisting the ISDA European Tax Committee with its work on FATCA;
- members of FATCA working group of the Alternative Investment Management Association; and
- members of the Tax Section of the New York State Bar Association and participants in its Subcommittees commenting on FATCA.

OUR EXPERIENCE INCLUDES

Principal legal advisor on FATCA implementation for several major international banks.

Regular and continuous advisor to numerous issuers and dealers on the impact of FATCA on capital market transactions and documentation.

Ongoing consultant to paying agents on various aspects of FATCA.

Advisor to a major U.S. financial institution on the impact of FATCA on its management of an umbrella investment company.

Advisor to major financial institutions on the impact of FATCA on ISDA documentation of swaps over U.S. equities.

Advisor to the U.S. subsidiary of a major manufacturing company on the impact of FATCA on its hedging portfolio.

FATCA advisor to several sovereign wealth funds.

FATCA publications and articles by Allen & Overy lawyers

Please click on these links to open up the article

Allen & Overy Bulletin, "U.S. Treasury Provides Grandfathering Relief, Clarifies Withholding on Dividend-Linked Payments"

March 2014

Bloomberg BNA, "Challenges of Compliance with U.S. FATCA: UK Data Protection and Bank Confidentiality Issues"

February 2014

Bloomberg BNA, "FATCA documentation requirements in capital and lending transactions"

January 2014

Bloomberg BNA, "UK 'son of FATCA' and recent information exchange proposals"

January 2014

Allen & Overy Bulletin, "FATCA IGA between the Netherlands and the U.S."

December 2013

Allen & Overy Bulletin, "FATCA Practice Point Series: Derivatives"

August 2013

Tax Notes International, "FATCA Final Regulations: Definitions List"

May 2013

Allen & Overy Bulletin, "U.S. Releases Second Model Intergovernmental Agreement"

November 2012

Allen & Overy Bulletin, "New FATCA Guidance Extends Scope of Grandfathering"

October 2012

Tax Journal, "Analysis: Challenges posed by FATCA"

October 2012

Allen & Overy Bulletin, "U.S. & UK Announce Intergovernmental Agreement for FATCA Implementation"

September 2012

PLC, "FATCA in Corporate Transactions"

August 2012

Allen & Overy Bulletin, "U.S. Releases Model Intergovernmental Agreement for FATCA Implementation"

July 2012

Allen & Overy Bulletin, "FATCA: Risk allocation in the European syndicated loan market"

March 2012

Allen & Overy Bulletin, "U.S. Treasury Proposal Clarifies Withholding on Dividend-Linked Swap Payments"

February 2012

Allen & Overy Bulletin, "Proposed Regulations Issued Under FATCA"

February 2012

Allen & Overy Bulletin, "Implications of Foreign Account Tax Compliance Act (FATCA): An Update"

January 2012

Allen & Overy Bulletin, "U.S. Tax and the Issuance of Debt Securities after the HIRE Act: An Update"

October 2011

Tax Journal, "The Worldwide Reach of FATCA"

July 2011

Allen & Overy Bulletin, "U.S. Tax and the Issuance of Debt Securities after the HIRE Act: A Guide for the Debt Capital Markets"

April 2010

LexisNexis Tax Directors' News, "U.S. Tax and the Issuance of Debt Securities after the HIRE Act: A Guide for the Debt Capital Markets"

April 2010



Recent events our FATCA team have spoken at

- Bloomberg BNA FATCA Seminar “Beyond FATCA Compliance”, London, November 2013
- IFA meeting: Joint CIOT/British Branch Cross Atlantic and European Tax Symposium, November 2013
- IBC Private Equity Tax Practices Conference, September 2013
- FATCA Presentation to LSTA Conference, May 2013
- Client Seminar Programme, FATCA: Known Knowns and Known Unknowns after the Financial Regulations, London, February 2013
- FATCA presentations, Dubai/Doha, November 2012
- IRS briefing to OECD/BIAC on FATCA IGA, Paris, September 2012
- Presentation on FATCA to the membership of the International Capital Markets Association, September 2012
- Allen & Overy Client Seminar Programme on “The Impact of FATCA on the Financial Markets”, Hong Kong and Australia, July 2012
- LSTA U.S. and European Primary Market Conference, London, February 2012
- IBC Conference on “Private Equity Tax Practices”, London, September 2011 and 2012
- American Bar Association Section of International Law and The International Division of the Law Society of England and Wales joint conference on “Capital Markets in the 21st Century”, London, December 2011

Next steps

For more information or to arrange an informal discussion, please contact :

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