FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

OVERVIEW

The Foreign Account Tax Compliance Act (“FATCA”) was enacted in the United States in 2010 and will be implemented over the course of the next several years. The rules are designed to compel foreign banks, funds, brokers and dealers, trust companies and similar foreign financial institutions to collect and report information on their U.S. customers. This legislation is in response to the U.S. government’s perception that, with the assistance of foreign financial institutions, U.S. persons are underreporting vast sums of money that is being hidden in offshore accounts. The rules are directly related to the widely reported scandals surrounding the U.S. government’s attempt to get information from banks such as UBS, which have led to a series of voluntary disclosure programs for U.S. persons to “come clean” with their under-reporting of foreign bank accounts.

On January 17, 2013, Treasury and the Internal Revenue Service (“IRS”) issued exceedingly detailed Final Regulations implementing FATCA. The bottom line is that beginning in 2014, foreign financial institutions will have to enter into agreements with the IRS to collect, verify and report certain information about their U.S. customers or, beginning in July 2014, face 30-percent withholding tax on their receipt of U.S.-source payments (which includes the gross proceeds from the sale of U.S. securities beginning January 2017, even if there is no gain on the sale).

In 2012, Treasury had released a groundbreaking Joint Statement from the United States, France, Germany, Italy, Spain and the United Kingdom regarding an intergovernmental approach to addressing FATCA compliance. For financial institutions in the countries issuing the Joint Statement, the same procedures will be in place but the reporting will be to their own government, which in turn will share such information with the United States on a reciprocal basis.

Implementation by foreign financial institutions of the rigorous standards to become compliant with FATCA will take time and effort. Key involvement will include oversight by the Board of Directors and perhaps the Audit Committee, as well as detailed involvement of the institution’s Chief Compliance Officer, Chief Information Officer, and Chief Tax Officer and their teams, among others.

BakerHostetler’s FATCA Advisory Team is uniquely situated to assist clients in evaluating their circumstances and strategizing as to the appropriate response to FATCA. BakerHostetler has significant experience in advising global financial institutions, trusts and trust companies, hedge funds and private equity funds in connection with compliance matters, U.S. withholding tax issues, information reporting matters, middle-man liability issues, effectively connected income issues, permanent establishment issues and treaty matters. This experience includes representation in IRS examinations, audits, appeals and litigation. The Advisory Team has been deeply involved in representation of individuals, trusts and companies in connection with foreign bank account reporting (“FBAR”) requirements, as well as civil and criminal representation stemming from the Offshore Voluntary Disclosure Initiatives (“OVDI”), which gives keen insight into what the government is seeking under FATCA. In addition, BakerHostetler has been appointed by the courts and voluntarily engaged by several major global financial institutions as an outside “monitor” to oversee efforts to become compliant with governing rules and regulations. Our white collar litigation practice has considerable depth in Foreign Corrupt Practices Act (FCPA) and “Know Your Customer” areas. BakerHostetler’s extensive work on behalf of Irving H. Picard, the SIPA Trustee for the liquidation of Bernard L. Madoff Investment Securities LLC (Madoff), as well as other matters, have given the firm unique and valuable experience in tracing funds, systems, and record keeping. The multidisciplinary BakerHostetler FATCA Advisory Team understands how to deal with U.S. and foreign governments and includes former U.S. government officials from the Treasury, IRS, Joint Committee on
Taxation, U.S. Congress (including former Congressman Mike Oxley, co-author of the Sarbanes-Oxley legislation), Department of State, Department of Justice, Tax Court, Securities and Exchange Commission and Office of the District Attorney of New York.

A detailed Alert describing the key aspects of FATCA and the Final Regulations can be found at http://www.bakerlaw.com/alerts/highlights-of-recently-released-fatca-regulations-2-12-2013/. A few salient points (the Who What Where When and Why) are summarized below.

FATCA

**WHO** should care about FATCA? Any Chief Compliance Officer, Chief Tax Officer or persons in similar roles at foreign banks, trusts or trust companies, hedge funds, private equity funds or similar foreign financial institutions that expect to earn any U.S.-source income. In the long-run, U.S. persons (individuals or companies) who make payments to any foreign financial institution should care, as they will become the withholding agent.

**WHAT** is FATCA? A broad set of requirements under which foreign banks, trusts, hedge funds and similar financial institutions will be required to collect, verify and report information on U.S. customers or face 30-percent withholding on U.S.-source payments.

**WHERE** does FATCA apply? FATCA is a U.S. rule that applies to non-U.S. financial institutions and, therefore, has extraterritorial reach. The penalty for failure to comply is withholding tax on U.S.-source payments. Accordingly, it is enforced through withholding at the source. There is no enforcement mechanism if the foreign financial institution does not receive U.S.-source payments directly or indirectly. To date, treaties do not adequately address FATCA. It is unclear which foreign governments will be able to negotiate special rules or treaty relief similar to the announced intentions issued in the Joint Statement among the United States, France, Germany, Italy, Spain and the United Kingdom.

**WHEN** is FATCA effective? There are a variety of important dates, but key among them is that withholding tax begins on **July 1, 2014**. Withholding on gross proceeds begins January 1, 2017. In order to avoid withholding, foreign financial institutions need to enter into an agreement with the IRS (to collect, perform due diligence and report information on U.S. customers) between **January 1, 2014, and April 25, 2014**. Accordingly, it will be important for foreign financial institutions that have not already done so to assess and evaluate their situation and to develop a strategy for compliance now.

**WHY** should foreign financial institutions respond to FATCA? The foreign financial institution has a choice. It can (i) comply with FATCA; (ii) fail to comply and face the punitive 30-percent withholding tax on U.S.-source payments; or (iii) choose to forgo business that generates U.S.-source payments. It is important to emphasize that if the foreign financial institution does not comply and receives U.S.-source payments, there is no “audit lottery” or other affirmative action that will need to be taken by the IRS. Rather, the requirements are enforced by any payor of any U.S.-source payment to the foreign financial institution. The payors become withholding agents, essentially deputized enforcers for the IRS. These deputies include compliant foreign financial institutions, which will be required to withhold on payments to non-compliant foreign financial institutions to the extent the payments are attributable to U.S.-source payments.
For More Information

For more information about the Foreign Account Tax Compliance Act, or if you have questions about how this legislation may impact your business, please contact any of the following BakerHostetler attorneys or visit our FATCA Information Page http://www.bakerlaw.com/internationaltax/fatca/:

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