MEMO# 26873

January 14, 2013

U.K. Guidance Implementing FATCA Intergovernmental Agreement

[26873]

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TO: ICI GLOBAL TAX COMMITTEE No. 1-13
RE:

U.K. GUIDANCE IMPLEMENTING FATCA INTERGOVERNMENTAL AGREEMENT

The draft guidance issued by Her Majesty's Revenue & Customs ("HMRC") to implement the Foreign Account Tax Compliance Act ("FATCA") intergovernmental agreement ("IGA") between the United Kingdom and the United States [1] provides important guidance for global funds. HMRC has requested that any comments on the draft guidance be received by 13 February 2013. The package consists of:

- draft regulations (to be promulgated pursuant to powers conferred by provisions of the U.K. Finance bill to be enacted in 2013); [2]
- draft guidance (referred to as "guidance notes"); [3] and
- a summary of responses received by HMRC to the consultation document released in September. [4]

ICI Global, as you know, filed detailed comments on HMRC's consultation document and the impact of the IGA on funds ("collective investment vehicles" or "CIVs") and their investors. [5] Our comments (on 16 of the 24 questions posed by HMRC) are reflected in HMRC's summary of responses and in the draft guidance.

If you have any suggestions for comments that ICI Global should make to HMRC, please provide them to Keith Lawson (lawson@ici.org or 001-202-326-5832) by 30 January 2013. Areas for possible comment, as discussed in greater detail below, include the definition of reportable account, the "certain collective investment vehicles" exception provided by the revised FATCA Model 1 IGA, the investor self-certification requirements, and the due diligence rules for "new accounts."

Definitions with CIV-Specific Application

Significant clarifications are provided regarding FATCA's application to CIVs under the IGA. Important terms for purposes of the new customer due diligence and reporting provisions include "reporting financial institution," "custodial institution," "investment entity," and “financial account.” The draft regulations propose an expanded definition of “reportable account” with an election to exclude certain accounts from otherwise-applicable reporting obligations.

Reporting Financial Institution. A “reporting financial institution” includes, among others, a custodial institution (as defined in section 2.11) [6] and an investment entity (as defined in section 2.13). The definition of an investment entity, in the context of CIVs, is discussed further in section 2.15.

Custodial Institution. A “custodial institution” is one that earns 20 percent or more of its gross income over specified periods from the holding of assets on behalf of others and from related financial services.   Custodial institutions could include brokers, custodial banks, trust companies, clearing organizations, and nominees.

Investment Entity. An “investment entity” is defined broadly to include CIVs, fund managers, investment managers, fund administrators, transfer agents, depositories, and trustees of unit trusts. The draft regulations, in section 6, provide rules for determining the reporting financial institution in the case of “collective investment schemes.” [7] If the scheme is constituted by a person, that person (and no one else) is the reporting financial person. If the scheme is constituted by a trust scheme, the trustees (and no-one else) are the reporting financial institution. In all other cases, the manager or operator of the scheme (and no one else) is the reporting financial institution.

Financial Account. The “financial accounts” that are relevant to CIVs, pursuant to section 3.10, are the equity and debt interests in the CIV itself (other than interests that are regularly traded – as defined under the Finance Act 2007 – on an established securities market). Importantly, any non-CIV entity that is within the definition of investment entity only by virtue of investing, administering, or managing CIVs is not considered to have financial accounts for which the new customer identification and reporting requirements apply.

Reportable Account. Reportable Account is defined broadly in section 5.1 of the draft regulations to include any account held by a U.S. person (“a U.S. reportable account”). Bracketed (proposed) language in section 5.2 of the draft regulations would provide financial institutions with an election to exclude from the definition of reportable account certain pre-existing individual accounts, certain new individual accounts, and certain pre-existing entity accounts (as provided, respectively, in Paragraphs A of Sections II, III, and IV of Annex I). By constructing the definition of reportable account in this manner, any financial institution that prefers to report on all U.S. accounts may do so without potentially violating data privacy laws. This construction effectively adopts the suggestion in ICI Global’s 23 November 2012 comment letter that a financial institution not be required to apply the reportable account exceptions for lower-value accounts, that are provided by IRS regulations and the U.K.-U.S. IGA, if the financial institution determines that it is more efficient to report on all accounts of all U.S. persons.

Application of these Rules in the CIV Context

The application of these rules in the CIV context is discussed further in paragraphs 2.16 through 2.19. The guidance distinguishes between distributors based upon whether or not they hold legal title to assets on behalf of their customers and are part of the legal chain of ownership of interests in CIVs.

Distributors that hold legal title to assets on behalf of their customers, and are part of the legal chain of ownership of interests in CIVs, are reporting financial institutions with respect to those interests. HMRC notes that these distributors (which could include nominees, intermediaries, and fund platforms) typically would be treated as custodial institutions (and hence as financial institutions irrespective of their relationship to the CIV). To eliminate any uncertainty in situations in which a particular institution might not meet the 20-percent-of-gross-income test for "custodial institution" treatment, HMRC will treat fund nominees, fund intermediaries, and fund platforms as custodial institutions unless specific factors indicate that they are better characterized as falling within the definition of investment entity.

Distributors that act only in an advisory capacity and are not in the chain of legal ownership of the CIV, in contrast, will not be regarded as reporting financial institutions in respect of the accounts on which they advise. Such distributors, which may include some independent financial advisors ("IFAs"), nevertheless may be asked by financial institutions to identify accountholders and obtain investor self-certifications (such as because they have the most in-depth knowledge of, and direct access to, the investor). Nevertheless, HMRC does not regard advisory-only distributors as financial institutions; the only obligations of these distributors will be pursuant to contractual agreements with those financial institutions for which they act as third-party service providers in relation to those accounts.

A detailed example of the relevant identification and reporting responsibilities in the CIV context is provided in section 2.19. The fund manager, because it typically is responsible for fulfilling a fund's regulatory obligations, normally will be responsible for complying with the obligations in relation to the fund's financial accounts. Importantly, as this section makes clear, the fund's account identification and reporting obligations apply only to its immediate accountholders. Intermediary financial institutions will have their own obligations to identify and report on their own accountholders (whose interests in the CIV are held, on the CIV's books, in an account in the intermediary's name).

Application to U.K. Financial Institutions

The IGA applies to entities ("U.K. financial institutions") that are resident or located in the U.K. U.K. residents, as provided in section 2.22, include: (1) a company that is incorporated in the U.K. or centrally managed and controlled in the U.K.; (2) a company that carries on a trade in the U.K. through a permanent establishment in the U.K.; (3) a trust if all of the trustees are U.K. residents; (4) a trust if some of the trustees are U.K. residents and the trust settlor is both resident and domiciled in the U.K. for trust purposes; and (5) a partnership if the control and management of the partnership's business as a reporting financial institution takes place in the U.K. An entity that is resident in the U.K. and another country will be required to apply the U.K. legislation.

Other Issues

Non-Reporting U.K. Financial Institutions and Products. The draft guidance (beginning with section 3.1) discusses those persons and accounts treated as "exempt beneficial owners," "deemed-compliant financial institutions," and "exempt products" pursuant to Annex II of the U.K.-U.S. IGA. Retirement accounts and products, for example, are listed in section 3.2, while certain other tax favoured accounts or products are listed in section 3.3.

One difference between the U.K.-U.S. IGA and the later-negotiated IGAs involves an "Annex II" exception, provided by the revised FATCA Model 1 IGA, for "certain collective investment vehicles" as deemed compliant financial institutions. [8] Under this deemed compliant exception, the FATCA obligations of a CIV that is regulated under the laws of the FATCA partner country are treated as being satisfied if (a) all of the CIV's interests are held by or through financial institutions that are not "nonparticipating financial institutions" or (b) another investment entity (such as the fund manager or administrator) satisfies all of the reporting requirements for the CIV's interests.

Due Diligence Procedures. Section 4 identifies the general due diligence requirements to be followed in identifying reportable U.S. accounts. These rules – which are designed to implement Annex I of the IGA and sections 9 and 12 of the draft regulations – address issues such as self-certifications, account aggregation, account closure balances, and many other issues. More specific due diligence requirements for pre-existing individual accounts, new individual accounts, pre-existing entity accounts, and new entity accounts are provided in sections 5 through 8.

Investor self-certifications are discussed in detail in sections 4.1 through 4.5. Importantly, the draft guidance allows a financial institution to choose the wording of its investor self-certification for new individual accounts. It is sufficient for an accountholder to confirm that he or she is neither a U.S. citizen nor a U.S. resident for tax purposes. If the financial institution's investor self-certification form requires a customer to specify his or her country of tax residence (which it might do to claim tax treaty relief), any customer specifying a tax residence other than the U.S. also must confirm that he or she is neither a U.S. citizen nor resident for U.S. tax purposes.

The draft guidance, in section 4.6, explains situations in which a financial institution must aggregate accounts. Under the guidance, aggregation is required only to the extent that a financial institution's computer system can link an account by reference to a data element (such as customer name, taxpayer identification number, or name and address). At the fund level, aggregation is required "to include sub funds and different share classes within that fund." Where two or more funds have a common third party performing due diligence obligations, aggregation across the different funds is not intended.

In reporting the balance or value of an account that is closed, section 4.7 provides that a financial institution must report the balance or value at the time the instructions to close the account are received from the customer.

The draft guidance, in section 6, for new individual accounts (defined as accounts opened on or after 1 January 2014) does not include any fund-specific rules. When a "new account" is opened by an individual who already has a "pre-existing account" with the "same entity," the financial institution still must apply the due diligence requirements to the new account. The due diligence performed on the "new account," however, then can be relied upon for any subsequent account that the individual opens with "that" financial institution.

Reporting. Reporting obligations are provided by sections 10,11, and 13 of the draft regulations and Annex I of the IGA. The draft guidance, in section 9, provides detailed rules regarding the information to be reported about U.S. persons, the timetable for reporting the information, and many other issues. Reporting formats and transmission protocols still are to be finalized.

Compliance. A comprehensive penalty regime for noncompliance is provided by sections 16 – 23 of the draft regulations. The draft guidance, in section 10, discusses minor errors, significant noncompliance, and the tax compliance risk management process. Section 10.1 provides that the country receiving information (e.g., the U.S.) may contact the U.K. financial institution directly to try and resolve corrupted or incomplete information.

Corrected information, however, will need to be resubmitted to HMRC for transmission to the recipient country. If the financial institution believes that an inquiry from the U.S. raises data privacy concerns, the institution should contact the U.K. competent authority (which will address this matter to the U.S. competent authority at the IRS).

Issues involving significant noncompliance are discussed in section 10.2. Examples of significant noncompliance include:

- intentional provision of substantially incorrect information;
- deliberate or negligent omission of required information;
- ongoing or repeated failure to register, supply accurate information, or establish appropriate governance or due diligence processes; or
- repeated failure to file a return or repeated late filing.

After either the U.S. or the U.K. competent authority determine that significant noncompliance has occurred and notify the other, the financial institution has 18 months to resolve the noncompliance. If the issues remain unresolved after 18 months, the financial institution will be treated as a nonparticipating financial institution and included on a list of such entities to be published by the IRS.

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endnotes

[1] See Memo # 26508, dated 17 September 2012.

[2] Available at: http://www.hmrc.gov.uk/drafts/uk-us-fatca-regulations.pdf.

[3] Available at: http://www.hmrc.gov.uk/drafts/uk-us-fatca-guidance-notes.pdf.

[4] Available at: http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_032480.

[5] See Memo # 26720, dated 26 November 2012.

[6] All references to "section," unless indicated otherwise, are to sections in the guidance notes.

[7] The term "collective investment scheme" is defined for this purpose as it is in the Financial Services and Markets Act 2000(a).

[8] The specific language for the "certain collective investment vehicle" exception appears on page 35 of the revised Model 1A IGA. See http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1A-Agreement-to-Implement-Reciprocal-11-14-2012.pdf.