Insights Skadden

Excerpted from *2014 Insights*. The complete publication is available at www.skadden.com.

'14

A COLLECTION OF COMMENTARIES ON THE CRITICAL LEGAL ISSUES IN THE YEAR AHEAD

Financial Institutions Wrestle With FATCA Implementation

CONTRIBUTING PARTNERS

Brian D. Christiansen / Washington, D.C.

Pamela Lawrence Endreny / New York

COUNSEL

Roseann M. Cutrone / Washington, D.C.

Sean M. Thornton / Washington, D.C.

Over the past year, financial institutions have wrestled with the challenges presented by the U.S. Foreign Account Tax Compliance Act (FATCA). Originally scheduled to take effect in 2013, the U.S. Treasury Department and IRS have delayed FATCA several times to give financial institutions more time to comply with the legislation's substantial burdens. As the current implementation date of July 1, 2014, approaches, financial institutions must continue to prepare despite the significant hurdles that remain.

Background

Congress enacted FATCA as part of the Hiring Incentives to Restore Employment (HIRE) Act in 2010 in a legislative effort to stop U.S. taxpayers from evading U.S. taxes through undisclosed offshore accounts. FATCA places significant requirements on foreign financial institutions, a term defined broadly to include not only foreign banks and custodial institutions, but also certain foreign insurance companies and investment entities such as hedge funds and private equity funds. FATCA requires foreign financial institutions to agree to report information about the holdings of U.S. taxpayers to the IRS. Failure to comply will result in an institution suffering 30 percent withholding tax on certain payments it receives from U.S. sources. FATCA also places new withholding and reporting obligations on U.S. financial institutions with respect to payments they make to foreign financial institutions and other foreign entities.

Industry Response and Intergovernmental Agreements

Many financial institutions have devoted considerable time and resources getting ready for FATCA. The effort involves putting into place new data collection systems and account opening procedures, performing due diligence with respect to existing accounts, and preparing for the extensive new withholding and information reporting that FATCA will require, among other things. Yet despite the progress of financial institutions to prepare for FATCA — and the Treasury Department and IRS having published detailed regulations, notices and other guidance — questions remain. Perhaps the most notable centers on the specific requirements that different foreign jurisdictions may impose pursuant to intergovernmental agreements (IGAs) with the United States.

For almost two years, the Treasury Department has worked to address local law impediments, such as bank secrecy laws that prevent the disclosure of information FATCA requires. The Treasury has been negotiating IGAs with different countries to facilitate the enforcement of FATCA in those jurisdictions by, for example, allowing foreign financial institutions in certain countries to report the required information to their local tax authorities (who will then provide the information to the IRS).

Although the Treasury has signed IGAs with a number of countries, many more remain in various stages of negotiation. Moreover, the IGAs contemplate that authorities in the relevant country will issue guidance implementing FATCA for institutions in that country. Yet only the United Kingdom has done so to date. As a result, financial institutions must prepare for FATCA based on the existing U.S. Treasury regulations and published IGAs. This raises a significant concern: The institutions may be preparing for specific

> "Financial institutions must prepare for FATCA based on the existing U.S. Treasury regulations and published IGAs."

compliance requirements that ultimately differ from the implementing guidance countries issue once the Treasury Department concludes the relevant IGAs with authorities in those countries.

Additional compliance issues include the fact that, although the Treasury has published drafts of new tax reporting forms to collect the extensive information that FATCA will require, it has yet to publish instructions and finalize the forms. Although we expect the Treasury to do so soon, this leaves a short amount of time for institutions to familiarize themselves with the detailed new forms and incorporate the reporting requirements into their systems. Financial institutions also need further guidance coordinating the existing withholding and reporting regime with the new FATCA requirements.

More Time?

In November 2013, several banking associations, including the American Bankers Association, the Clearing House Association, the Institute of International Bankers, and the Securities Industry and Financial Markets Association, asked the Treasury Department and the IRS to further delay the timeline for FATCA in light of the administrative challenges and the uncertainties still existing. Treasury and IRS officials have said, as recently as January 14, that the government will not extend the dates.

In the meantime, as FATCA's start date approaches, financial institutions undoubtedly will continue to prepare and, absent further extension, voice concerns over this far-reaching legislation.