FATCA Finally Takes Effect, Subject to Transition Rules

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After several years of delays, the Foreign Account Tax Compliance Act (FATCA) finally took effect on July 1, 2014. Congress enacted FATCA as part of the Hiring Incentives to Restore Employment Act in 2010 to stop U.S. taxpayers from evading U.S. taxes through undisclosed offshore accounts and investments. FATCA requires foreign financial institutions — defined broadly to include not just foreign depositary or custodial institutions but also some foreign insurance companies, investment funds and other entities — to report to the Internal Revenue Service (IRS) information about the holdings of U.S. taxpayers or face 30 percent withholding on certain payments they receive. FATCA also imposes new withholding and reporting obligations on U.S. financial institutions as well as nonfinancial U.S. companies with respect to payments they make to foreign entities.

The U.S. Treasury Department and IRS delayed FATCA's effective date several times in order to give institutions more time to prepare to comply with FATCA's sweeping requirements, as well as to allow the Treasury and IRS to finalize detailed regulations and forms necessary for FATCA's implementation. The extra time also allowed the IRS to put into place its Internet portal — which each foreign financial institution must use to register and receive the global intermediary identification number (GIIN) it needs to evidence FATCA compliance to payors — and update frequently asked questions and answers about FATCA on its website.

Shortly before July 1, 2014, the Treasury and IRS released transition rules, further delaying implementation of the rules with respect to foreign entities. Thus, although FATCA took effect July 1, under the transition rules certain due diligence, reporting and withholding requirements do not take effect until 2015 or 2016. In addition, the IRS said that, for purposes of FATCA enforcement, it will consider 2014 and 2015 transition years and will take into account the extent to which institutions have made good faith efforts to comply.

Also, in the time leading up to July 1, the Treasury negotiated intergovernmental agreements (IGAs) with dozens of different countries implementing FATCA for institutions in those jurisdictions. The IGAs address local law impediments, such as bank secrecy and data protection laws, that would prevent institutions in those countries from fully complying with FATCA, and in some cases provide that institutions report to the local government rather than to the IRS. The Treasury and IRS will treat countries that have agreed in substance to an IGA but have not yet entered into one as having an IGA in effect and therefore will consider financial institutions in those jurisdictions to be FATCA-compliant for a period of time. Meanwhile, the Treasury has continued to conclude additional IGAs. Institutions in IGA jurisdictions ultimately will be governed by laws enacted by their local jurisdictions to implement FATCA. A handful of countries (including the United Kingdom, Ireland and the Cayman Islands, among others) have enacted FATCA laws or at least published guidance in draft form, while many countries have not yet done so.

Notably, the Organisation for Economic Co-operation and Development has released a common reporting standard (CRS) for Automatic Exchange of Financial Account Information based on FATCA and a model Competent Authority Agreement. Under the CRS, countries that choose to participate will collect information from financial institutions in their

jurisdictions and will automatically share that information with their exchange partner countries in exchange for reciprocal information, thereby allowing participating countries to obtain the same type of data about their own taxpayers that the U.S. will obtain under FATCA.

Despite the considerable time and resources devoted to FATCA's implementation, unresolved issues remain. Institutions are finding that many people have difficulty understanding how to complete the complex new IRS forms that FATCA requires. In addition, aspects of the interaction between the Treasury regulations and the IGAs are still unclear. Moreover, because the IGAs contemplate that each country ultimately must enact its own specific rules implementing FATCA, institutions face the uncertainty of having to comply with requirements and interpretations in different jurisdictions that have not yet been put into place but may ultimately differ from the Treasury regulations.

In sum, FATCA — initially met with widespread resistance and disbelief by financial institutions in the U.S. and abroad — has become a reality and, indeed, the model for some other countries as they move toward greater tax transparency. In the meantime, institutions must grapple with FATCA's continuing challenges as best they can.