SULLIVAN & CROMWELL LLP

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FATCA: New Government-to-Government Model

U.S. Treasury Department Issues Joint Statements with Japan and Switzerland Outlining a New Intergovernmental Model

SUMMARY

On June 21, 2012, the U.S. Treasury Department released two separate joint statements with the governments of Switzerland and Japan (the "Switzerland Joint Statement" and "Japan Joint Statement" and collectively, the "Joint Statements"). These statements outline a new framework under which "foreign financial institutions" ("FFIs") in Switzerland and Japan could more easily comply with the requirements of FATCA. In contrast to the February 2012 proposal issued by the U.S. Treasury Department and five European governments, which contemplates substantial information exchange between governments (the "Intergovernmental Model"), the Joint Statements contemplate that FFIs would report their U.S. accounts directly to the IRS, and the role of the local tax authorities would be limited to serving as an intermediary for information regarding recalcitrant account holders (the "Supplemental Model"). Entering into such an agreement would (i) relieve FFIs in the relevant jurisdiction from having to withhold on so-called "passthru payments," (ii) clearly identify certain types of FFIs in that jurisdiction as "deemed compliant," and (iii) provide other measures to reduce the burden of FATCA compliance.

The Joint Statements, as well as public comments by Treasury Officials last week, indicate that the U.S. is open to adopting either approach with interested countries.

BACKGROUND

FATCA was enacted in March 2010, as a section of the "Hiring Incentives to Restore Employment Act."[1] FATCA is intended to reduce the evasion of U.S. tax by U.S. citizens and residents who hold offshore assets, and seeks to accomplish this objective by imposing a 30% withholding tax on "withholdable payments" made to FFIs that do not sign an agreement with the IRS to report information regarding their U.S. account holders. FATCA also requires FFIs that sign such an agreement to withhold on "passthru payments" made to "recalcitrant account holders" and to FFIs that do not sign an FFI agreement with the IRS.[2]

In February 2012, in conjunction with the issuance of proposed FATCA regulations, the Treasury Department jointly released the Intergovernmental Model in a joint statement made with five European countries.[3] The Intergovernmental Model outlined the commitment of the IRS and the other signatories to pursue a cooperative approach to FATCA implementation and provides a framework for significant bilateral information-sharing agreements with countries that agree to become "FATCA Partners". In particular, a FATCA Partner would agree to collect the information required under FATCA from FFIs in its jurisdiction and transfer this information to the United States, and the United States would commit to reciprocally collect and report information about the U.S. accounts held by residents of the FATCA Partner. Under the Intergovernmental Model, the United States would not require FFIs located in the jurisdiction of a FATCA Partner to sign an agreement directly with the United States (though they may be required to register with the IRS), and would instead allow such FFIs to comply with FATCA by reporting to the FATCA Partner instead of the IRS. FFIs in the FATCA Partner would also not be subject to U.S. withholding under FATCA, would not be required to withhold on passthru payments to recalcitrant account holders and other FFIs organized in any FATCA Partner, and would not be required to terminate the accounts of recalcitrant account holders.

THE JOINT STATEMENTS

The Supplemental Model described in the Joint Statements provides an alternative to the government-to-government reporting approach described in the Intergovernmental Model. Under the Supplemental Model, FFIs in Japan and Switzerland will generally be able to report information about their U.S.

1 The provisions of the U.S. Internal Revenue Code that represent FATCA derive their name from the fact that they were originally introduced as a separate bill entitled the "Foreign Account Tax Compliance Act".

2 Passthru payments include "withholdable payments," which are generally payments of U.S. source-income and gross proceeds from the sale of property which can produce U.S.-source interest or dividends. Passthru payments also include certain non-U.S. source payments, although the definition of these "foreign passthru payments" was reserved in the most recent round of FATCA guidance, so it is not yet known what "foreign passthru payments" may be subject to FATCA withholding.

3 The five jurisdictions covered by the Intergovernmental Model are France, Germany, Italy, Spain and the United Kingdom.

accounts directly to the IRS. However, in limited cases, information would be obtained from the Swiss or Japanese government by the IRS, through a request under the respective treaty. The "benefits" provided under the Supplemental Model are similar to the "benefits" that FFIs located in FATCA Partners would receive under the Intergovernmental Model, namely that FFIs in the FATCA Partner jurisdiction would not be subject to U.S. withholding under FATCA, would not be required to withhold on passthru payments to recalcitrant account holders and other FFIs organized in any FATCA Partner, and would not be required to terminate the accounts of recalcitrant account holders. However, FFIs located in jurisdictions that adopt the Supplemental Model would be required to register with the IRS (Japan) or enter into FFI agreements with the IRS (Switzerland).

The approach set forth in the Japan Joint Statement states that the Japanese government intends to:

- "direct and enable" financial institutions in Japan (other than exempted or deemed complaint FFIs) to register with the IRS and comply with FATCA guidance issued by Japan's Financial Service Agency. This guidance will include requirements that are "consistent with" the obligations of FFIs under FATCA, including (i) due diligence to identify U.S. accounts, (ii) annual reporting (directly to the IRS) of information about U.S. accounts, and (iii) annual reporting (directly to the IRS) of aggregate information about recalcitrant accountholders; and
- accept requests from the IRS regarding Japanese FFI recalcitrant account holders, which were reported to the IRS by Japanese FFIs on an aggregate basis.

In exchange, the IRS would:

- eliminate the requirement that Japanese FFIs enter into comprehensive FFI agreements with the IRS;
- identify specific Japanese financial institutions or entities to be treated as deemed compliant or exempt from FATCA;
- eliminate U.S. withholding under FATCA on Japanese FFIs that register with the IRS and meet the required due diligence and reporting obligations; and
- provide certain other measures (which are not specified in the Japan Joint Statement) to reduce the burden of, and simplify, FATCA compliance by Japanese financial institutions and entities.

In addition, Japanese FFIs would be exempted from the general requirements under FATCA to:

- terminate accounts of recalcitrant accountholders; and
- impose passthru payment withholding on payments to recalcitrant accountholders, FFIs organized in Japan that have registered with the IRS and met the required due diligence and reporting obligations, and FFIs in other countries with which the IRS has a FATCA agreement.

The Switzerland Joint Statement is similar to the Japan Joint Statement, but there are key substantive differences. These include:

- an agreement by the Swiss government to grant an exception to Swiss law so that Swiss financial institutions are able to comply with the FATCA obligations and FFI agreements with the IRS;

- that Swiss FFIs (other than exempted or deemed compliant FFIs) would not merely register with the IRS and agree to perform due diligence and reporting obligations, but would sign comprehensive FFI agreements with the IRS; and
- a statement in the Switzerland Joint Statement that (i) a model Cooperation Agreement will be developed (and that the terms and conditions in this model will be applied to Switzerland and other interested countries on an equivalent basis) and (ii) the United States and Switzerland will work swiftly and constructively to negotiate and conclude a Cooperation Agreement.

ANALYSIS

The Joint Statements call for a more limited approach to information exchange than the framework outlined in the Intergovernmental Model.

The Japan Joint Statement observes that the United States remains open to an intergovernmental approach to FATCA. U.S. Treasury officials have also been quoted in the press as stating that the U.S. is willing to enter into FATCA agreements with other governments under either model. In April, the IRS and Treasury Department finalized regulations that will require banks to report the amount of interest earned on U.S. bank deposits to the IRS.[4] The information reporting required by these regulations is likely to be necessary in order for the IRS and non-U.S. tax authorities to implement the framework called for by the Intergovernmental Model, meaning that the approach called for in the Joint Statements may become the primary method by which the IRS and Treasury Department seek international cooperation to implement FATCA. However, legislation has been introduced in Congress to block the implementation of these regulations, which are due to take effect on January 1, 2013. It is also noteworthy that the Japan Joint Statement observes that "The United States and Japan would be willing to work with other FATCA partners and the OECD in the medium term on developing a common model for automatic exchange of information, including the development of reporting and due diligence standards." This statement suggests that a higher level of intergovernmental information exchange may remain a long-term goal of the IRS and Treasury Department, but that time constraints or other factors could mean that arrangements such as those outlined in the Joint Statements, which involve direct reporting from FFIs to the IRS, will be more common in the short term.[5]

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[4] For a discussion of these regulations, please see the Sullivan & Cromwell LLP publication entitled "Information Reporting – Interest Paid to Non-U.S. Individuals on U.S. Bank Deposits: IRS and the Treasury Department Issue Final Regulations Requiring the Reporting of Interest or Original Issue Discount ("OID") Paid to Nonresident Alien Individuals on Bank Deposits" (April 20, 2012), which can be obtained by following the instructions at the end of this publication.

[5] The Swiss Joint Statement does not contain an equivalent observation.

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