PRESENTATION ON THE FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA) FOR CONSULTATIONS WITH THE INDUSTRY

Prepared for the
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EASTERN CARIBBEAN CENTRAL BANK
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LIST OF ACRONYMS

FDAP	-	Fixed, Determinable, Annual, Periodical
ECCB	-	Eastern Caribbean Central Bank
ECCU	-	Eastern Caribbean Currency Union
FATCA	-	Foreign Account Tax Compliance Act
IRS	-	Internal Revenue Service
FFI	-	Foreign Financial Institution
NFFE	-	Non-Financial Foreign Entity
TIN	-	Tax Identification Number
US	-	United States
USWA	-	US Withholding Agent
PFFI	-	Participating Foreign Financial Institution
NPFFI	-	Non-Participating Foreign Financial Institution

UNITED STATES FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA): REPORT ON THE WAY FORWARD

1.0 BACKGROUND

On 18 March 2010, the US government enacted FATCA, a derivative of the Hiring Incentives to Restore Employment Act, to combat tax evasion by US persons[1] holding investments in offshore accounts. FATCA requires FFIs[2] to report directly to the US IRS, information on assets held by US taxpayers, or by foreign entities in which US taxpayers hold substantial[3] ownership interest. Since the enactment of FATCA, the IRS has issued a series of notices and proposed regulations to provide guidance on the full implementation of the FATCA reporting and withholding obligations.

2.0 KEY PROVISIONS OF FATCA

Under FATCA, certain FFIs are required to enter into an FFI Agreement with the IRS. The agreement outlines the FFI's legally binding responsibilities which fall into four major categories: pre-existing accounts, new accounts, withholding and reporting. Institutions are stratified and depending on specific thresholds, some institutions may be deemed compliant and will therefore not be required to enter into agreements with the IRS.

Table 1 – Categories of Responsibility under FATCA

Pre-Existing Accounts	• For accounts with a balance between $50,000 and $1,000,000, FFIs are required to perform a review of an electronically searchable account database in an effort to determine if an account has any indicia of US status. • If indicia status is found, the FFI is required to obtain additional information to substantiate the status. • Should the information not be acquired, the account will be considered recalcitrant.
New Accounts	• FFIs are required to determine if US indicia exists during the account

[1]The Term "specified US person" generally means any US person, *excluding*, (a) a corporation and any member of the same affiliated group; (b) a real estate investment trust; (c) the United States or any wholly owned agency; and (d) a US tax-exempt organization.

[2] Includes, banks and brokers and dealers and trust companies, as defined in Appendix I

[3] Generally greater than 10.0 per cent.

	opening process. Should US indicia be determined, FFIs are required to obtain documentation to substantiate the account holder's status. • Accounts opened after the FFI agreement's effective date are new accounts. The earliest possible date for this is 01 July 2014.
Withholding	• A withholding agent will be required to withhold 30.0 per cent of a withholdable payment made to a non-participating FFI or to a passive NFFE that fails to provide information with respect to its substantial US owners. • There are two types of withholdable payments: o US source FDAP Income; and o Gross proceeds from the sale of property that can produce US source dividends or interest.
Reporting	• Reporting requirements will be phased in, between 2015 and 2017. • Identifying information such as name, address, TIN, account number and balance or value would be reported from 2015 and 2016. Beginning in 2017, reporting may be required for income and in 2018 it could be expanded to include gross proceeds from the sale of securities. • The proposed regulations require FFIs to report any information in US dollars or in the currency in which the account is maintained.

3.0 FATCA COMPLIANCE TIMELINE

Table 2 outlines several key dates for FATCA, the most significant of these deadlines being the 1 July 2014, the implementation date for FATCA.

Table 2: Key FATCA Dates

Key Activity	**Due date**[4]
Opening of IRS Portal for registration of all financial institutions	**19 August 2013**
Deadline for registration on IRS Portal	**25 April 2014**
Circulation of list of compliant FFIs	**2 June 2014**
Commencement of collection of information by FFIs	**01 July 2014**
Submission of 2014 data to the IRS by National Competent Authority	**March 2015**

[4] These dates were revised based on the US Department of Treasury and the IRS Notice 2013-43 issued on 12 July 2013, which provided a revised timeline and other guidance, regarding the implementation of FATCA.

4.0 REVIEW OF THE REPORTING REQUIREMENTS OF FATCA

FATCA will require FFIs to report to the IRS certain information about financial accounts held by US taxpayers or by foreign entities in which US taxpayers hold a substantial ownership interest. FFIs will therefore be required to register with the IRS by 25 April 2014. The participating FFIs will be obligated to:

a. Undertake certain identification and due diligence procedures with respect to account holders;
b. Report annually to the IRS on account holders who are US persons or foreign entities with substantial ownership; and
c. Withhold and pay to the IRS 30.0 per cent of any US-sourced income, as well as gross proceeds from the sale of securities that generate US-sourced income, made to:
    i) NPFFIs,
    ii) Individual account holders failing to provide sufficient information to determine whether or not they are a US person, or
    iii) Foreign entity account holders failing to provide sufficient information about the identity of its substantial US owners.

5.0 IMPLICATIONS OF FATCA FOR THE ECCU FINANCIAL SECTOR

Achieving FATCA compliance would pose challenges for ECCU financial institutions as it would require significant financial outlay to implement the procedures and processes necessary to ensure compliance.

5.1 New Cost Centre

The establishment of a FATCA unit within each institution would constitute a new cost centre which would inevitably pose a financial challenge for some institutions. This additional expenditure could further constrain income and further reduce profitability which was already under pressure as a result of the impact of the global financial crisis. Some of the expenditure relates to the appointment of a special compliance officer who would be required to register with the IRS, instituting changes in customer account opening documentation and regular reporting to the IRS. These would involve additional expenses associated with staff training, and legal and other costs in amending customer agreements and cost of upgrading or

enhancing existing software or procuring new software with the capabilities to produce the necessary reports to the IRS. Further, financial institutions would be required to pay for audits to ensure that their systems continue to comply with the signed FFI Agreements.

5.2 New Customer Acceptance and Due Diligence Procedures

The implementation of FATCA at a granular level requires a change in FFIs' current customer acceptance and due diligence policies and procedures. It requires institutions to identify whether a prospective customer can be deemed a US person. This would involve the collection of documentation to prove or disprove a US connection for each new customer. If the customer chooses not to provide that information, the institution must categorise the account as a recalcitrant account.

5.3 Potential Loss of US Customers

A compliant FFI must report regularly on accounts held by US persons with balances greater than US$50,000. There may be a loss of accounts as a result of institutions being forced to terminate relationships with customers and entities which fail to comply with the new disclosure requirements. The increased due diligence requirements may also discourage investors from opening accounts with non-US entities. This would lead to the loss of potential US customers.

5.4 Potential Loss of Correspondent Banking Relationships

The added costs of monitoring and withholding payments may potentially diminish the value added to correspondent banks in maintaining accounts for ECCU financial institutions. These additional costs and responsibilities may be grounds to terminate a correspondent arrangement if the costs of the relationship outweigh the benefits to the correspondent bank. This would have serious implications on the banking sector as smaller indigenous institutions may be most vulnerable to the potential risk of loss of correspondent relationships.

5.5 Penalties for Non-Compliance

Section 1471 (a) of FATCA states:

> ***"where a FFI does not satisfy the reporting requirements of the Act, a withholding agent will deduct and withhold a 30 per cent tax on any withholdable payment".***

Failure to comply with this provision, either partially or wholly would result in the IRS imposing tax penalties on non-compliant FFIs.

Additionally, where a customer fails to give information to an FFI to assist in determining whether an account qualifies as a "US Account" or fails to grant the waiver to allow for the disclosure of the information by the FFI, they are defined as being 'a recalcitrant account holder' in ***section 1471 (d) (6).*** This non-compliance would result in a 30.0 per cent deduction being effected on any 'passthru payment' relating to such person. Participating FFIs would be expected to withhold a 30.0 per cent deduction as it relates to passthru payments for NPFFIs and recalcitrant account holders. Section 1471 (b) (F) (ii) states:

> ***"if a waiver described in clause (i) is not obtained from each such holder within a reasonable period of time, the participating FFI has an obligation to close such account"***.

Financial institutions operating in the ECCU may be open to litigation by customers who may deem the closure of their accounts to be unlawful in view of the current legal framework in the ECCU.

6.0 LEGAL IMPEDIMENTS TO ECCU FATCA COMPLIANCE

FATCA requires FFIs to undertake the responsibility of collecting and reporting personal information about their customers. However, section 32(1) of the Banking Act specifically outlines the circumstances under which such information could be disclosed. Commercial banks have a duty to supply information to the respective ECCU Governments and the ECCB

as the sole regulatory authority under the Banking Act. The mandates of FATCA surpass the contemplation of the current legislative structures within the ECCU. The IRS is a foreign authority with no jurisdictional claim within the ECCU and therefore has no legal basis upon which such demands could be made.

FFIs must obtain a waiver of confidentiality laws from their customers to allow for the disclosure of personal information to the IRS. This would qualify as a "written authorization" under section 32 (1) (a) of the Banking Act. Therefore, a waiver would be sufficient to justify the disclosure of customers' personal information to the IRS by commercial banks.

Similarly, the confidentiality clauses enshrined in other financial services legislation also prohibits the sharing of customer information. However, disclosure would be permitted in the following circumstances:

1. where permission is granted by the customer;
2. under the provisions of the specific financial services legislation;
3. as required by a court of competent jurisdiction; and
4. under the provisions of any other law, or multilateral agreement between governments.

The FATCA requirements of imposing a tax levy and demanding the closure of accounts, as it relates to recalcitrant account holders and non-compliant FFIs, effectively gives the IRS 'regulatory-type' status beyond US borders and within the ECCU. Further, there is no legal basis upon which the banks can withhold funds for and on behalf of a foreign entity with no jurisdictional authority in the ECCU.

Section 1474 (a) of FATCA provides that where an FFI complies with the withholding requirement, the FFI would be indemnified against any claims being made in relation to withholdable payments. FATCA is not part of the ECCU legislative framework and cannot offer protection to FFIs that purport to impose the penalties of FATCA. Therefore, the banking industry would be vulnerable to litigation commenced by affected customers and non-compliant FFIs. The IRS is not an entity recognized as having any jurisdictional authority in

the ECCU and any action which is attempted to be justified under FATCA may not be favourably treated by the courts of law in the region.

FATCA seeks to create a liability between the IRS and participating FFIs if these institutions fail to comply with the withholding requirements. ***Section 1474 (a)*** requires that any person who is obliged to withhold tax is deemed liable for such monies. This would also apply to NPFFIs. This obligation is similar to that owed to a regulatory authority, which in our jurisdiction, the IRS is not.

The ultimate objective of FATCA is to levy taxes upon persons qualified under FATCA, who have assets beyond US borders. The scope of FATCA would include persons holding dual citizenship in ECCU territories and the US. It is therefore possible that persons may be subject to double taxation, a situation where they are taxed within their respective ECCU territories and by the US as well. It is noted that none of the ECCU territories are listed as having Income Tax Treaties with the US, such as what pertains with Jamaica, Trinidad and Tobago and Barbados.

7.0 CONCLUSION

FATCA compliance will undoubtedly require the allocation of significant resources by financial institutions in areas including but not limited to human resources, systems and processes. The path to compliance may not be a prescriptive one for financial institutions; however reforms are being crafted at a systemic level for efficient implementation of systems that allow for FATCA compliance. Specific legal reforms are being drafted within which ECCU financial institutions would comply with the provisions of FATCA without fear of contravening the current legal structure in the ECCU. The breadth and complexity of the identification and reporting requirements contained in the proposed regulations will pose significant challenges for many financial institutions and withholding agents alike.

APPENDIX

DEFINITIONS

(i) Foreign Financial Institution

A foreign financial institution (FFI) is defined as one that is a non-U.S. entity. The term generally includes any entity that: (a) accepts deposits in the ordinary course of a banking or similar business; (b) as a substantial portion of its business, holds financial assets for the account of others; (c) is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, notional principal contracts, insurance or annuity contracts or any interest in such securities, partnership interests, commodities notional principal contracts or insurance or annuity contracts or (d) is an insurance company making payments with respect to financial accounts. An entity is treated as engaged primarily in the business of investing, reinvesting, or trading if the entity's gross income from those activities is at least 50% of the entity's total gross income over the current and prior two years. This category of FFIs will generally cover non-U.S. investment funds.

(ii) US account

The FATCA defines the term "U.S. account" (subject to FATCA reporting) as any "financial account" held by one or more "specified U.S. persons" or "U.S.-owned foreign entities," with certain exceptions.

(iii) Financial Account

The statute defines the term "financial account" as including any depository account, custodial account, or equity or debt interest in an FFI, other than interests that are regularly traded on an established securities market. A financial account does not include any account held solely by one or more "exempt beneficial owners" or by non-participating FFIs holding the account as intermediaries solely on behalf of one or more such owners. The statutory definition of financial account includes the traditional bank, brokerage, money market accounts, and interests in investment vehicles, and excludes

most debt and equity securities issued by banks and brokerage firms, subject to an anti-abuse rule. Debt or equity that is traded on an "established securities market" on at least 60 days during the prior year will not be treated as a financial account.

(iv) An Obligation

Any legal agreement that produces or could produce a withholdable payment or "passthru payment," other than an instrument treated as equity for U.S. tax purposes or lacking a stated expiration or term, such as a savings deposit or demand deposit. However, "obligation" does not include an agreement to hold financial assets for the account of others and to make and receive payments of income and other amounts with respect to such assets (e.g., brokerage or custodial agreements) or an agreement that merely set forth general and standard terms and conditions and that does not set forth all of the specific terms necessary to conclude a particular contract.

(v) A Recalcitrant Account

In general the holder of an account will be treated as a recalcitrant account holder if:

- The holder fails to comply with requests to by the PFFI for the documentation or information that the PFFI is required to conduct in order to determine whether the account is a U.S. account;

- The holder fails, upon a request from a PFFI, to provide a valid form W-9 or a correct name and TIN combination when the PFFI has received notice from the IRS indicating that the name and TIN combination reported by the PFFI is incorrect; or

- The holder fails (or if the holder is a U.S.-Owned Foreign Entity, any of its Substantial U.S Owners fails) to provide a valid and effective waiver of any foreign law would prevent reporting by the PFFI with respect to the account.

A holder of an Excluded Depository Account will not be treated as a recalcitrant account holder, nor will a holder of a pre-existing individual account that qualifies for one of the exemptions from the PFFI's due diligence requirements, if the PFFI elects to apply that exemption. In addition, an account holder will not be treated as a recalcitrant account holder if it is, or is presumed to be, an FFI; rather the appropriate circumstances, it will be treated as a non-participating FFI.

(vi) Exempt Parties (Exempt beneficial owners)

These include (a) any foreign government or agencies or instrumentalities thereof, (b) international organizations and (c) foreign central banks. The definition also includes (x) governments of U.S. territories, (y) foreign retirement plans that fit within specific criteria set forth in the Proposed Regulations and (z) an FFI described in the third category of "financial institutions" primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, etc.) if it is wholly owned by one or more other exempt beneficial owners. A foreign retirement plan generally will be treated as an exempt beneficial owner if the fund (a) is eligible for the benefits of an income tax treaty with the United States on U.S.-source income, (b) generally is exempt from income tax in its home country and (c) operates principally to administer or provide pension or retirement benefits.

(vii) Withholdable Payment

Withholdable payments are defined as payments of i) interest, dividends, rents and other fixed or determinable annual or periodical gains, profits and income (FDAP income), if such payment is from sources within the United States; and ii) gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the United States. Section 1471 imposes a 30.0 per cent withholding tax on "withholdable payments" made to FFIs that do not enter into "FFI Agreements" (and who are not "excepted" FFIs or "deemed-compliant" FFIs).

(viii) Withholding Agent

The term 'Withholding Agent' means all persons, in whatever capacity acting, having the control receipt, custody, disposal, or payment of any withholdable payment.

(ix) Passthru Payment

The statute defines the term passthru payment as 'any withholdable payment or other payment to the extent that such payment is treated as attributable to a withholdable payment (*i.e.*, payments made by PFFIs that are treated as attributable to withholdable payments, but are not themselves withholdable payments, such as interest on bank accounts maintained by PFFIs and distributions to shareholders by corporate PFFIs). A withholding Agent is required to withhold 30.0 per cent of any passthru payment made to a non-participating FFI. The underlying purpose of the passthru payment rule is to encourage FFIs to enter into FFI agreements if they hold investments that produce payments are attributable to withholdable payments even if an FFI does not directly hold an investment asset that produces a withholdable payment.

(x) US Indicia

Indicia of US status for private banking accounts include:

(i) U.S. citizenship or lawful permanent resident (green card) status;

(ii) U.S. birthplace;

(iii) U.S. residence address or a U.S. correspondence address (including a U.S. P.O. Box);

(iv) Standing instructions to transfer funds to an account maintained in the U.S. or directions regularly received from a U.S. address;

(v) An "in care of address or a "hold mail" address that is the sole address with respect to the client or

(vi) Power of Attorney or signatory authority granted to a person with a U.S. address.

If U.S. indicia are present, the FFI has to request a Form W-9 or FormW-8BEN and other documentation as necessary from the client, possibly including a waiver when foreign law would prevent disclosure of information to the IRS.