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*Inconsistency issues between the FATCA final
regulations and the IGAs*

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Management,*

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Inconsistency issues between the FATCA final regulations and the IGAs

An exploration of the drivers and industry challenges that have emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs, and potential solutions to address these industry challenges

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Foreword

This thesis is written as completion of the Bachelor of Science of Tax Law and Economics at the Rotterdam University of Applied Sciences. The report consists of a theoretical analysis, and reveals the scope of inconsistencies between the FATCA final regulations and the IGAs.

The Foreign Account Tax Compliance Act ("FATCA") is a very recent US tax regime with implications for international funds. FATCA's complexities compounded with Treasury's inconsistent approach towards FATCA resulted in unintended industry challenges. These inconsistencies and unintended challenges peaked my interest in investigating the FATCA regime. New regulations' updates are published on a weekly basis thereby giving the impression of a moving target, spawning instability and confusion in the market. While new regimes are always subject to improvement, confusion regarding their interpretation is cause of concern. This concern is the main reason why I am investigating FATCA. My aim is to provide insights in the workings of FATCA and to provide meaningful recommendations regarding improvements needed so as to hopefully better align FATCA's regulations with the IGAs performance.

As part of this research I formed part of the KPMG FATCA team. I dove deep into this complex regulation and was awarded the opportunity to work on many FATCA engagements. My work experience became part of the field research. The opportunity to be a member of the KPMG FATCA team has been an incredibly rewarding experience. While working on FATCA engagements, I received insights into industry challenges faced to date as a consequence of FATCA workings. During my time at KPMG LLP I received the opportunity to work with the best FATCA experts in the industry where I gained experience and insights into the FATCA regime. The opportunity to form part of the KPMG FATCA team also contributed to the development of my future career focus as a specialist in International Tax, specifically FATCA.

Throughout the entire research process I've received guidance and collaboration from multiple FATCA experts at KPMG LLP all of whom I want to extend my sincere gratitude. First of all, I would like to thank all my colleagues at KPMG LLP for an incredibly rewarding and memorable experience and for having given me the opportunity to learn and develop my skills during my time at KPMG LLP. Secondly, I would like to give a special thank you to Deirdre Joyce who has guided me throughout my internship at KPMG LLP. Deirdre has taught me a lot regarding FATCA and she has taken precious time in directing me during the research process. I would also like to thank Brian Lozada and David Richardson for their contribution and insight with respect to my thesis and for giving me the opportunity to be part of the KPMG FATCA team. I also want to extend my gratitude to Michael Plowgian, Elizabeth Schreppel and Benno Oldenhof for their contribution with respect to my thesis.

During the research process I've also received guidance from Josephine Groeneveld from the Rotterdam University of Applied Sciences. I would like to give Josephine Groeneveld a special thanks for all her help and guidance throughout the process. I would also like to thank Abdel El-Yalte for his guidance and support throughout the entire graduation process.

TABLE OF CONTENT

List of abbreviations	7
Introduction.....	8
Problem statement.....	9
Central question and key questions.....	10
Objective	10
Target audience	11
Chapters	11
Limitation.....	12
Final product	12
Expertise	12
1 Methodical framework	14
1.1 Introduction	14
1.2 Research strategy.....	14
1.3 Resources and research methods.....	16
1.4 Methodical justification.....	17
2 Foreign Account Tax Compliance Act ("FATCA").....	18
2.1 Introduction	18
2.2 FATCA Final Regulations	18
2.3 Entity classification	20
2.4 Due diligence Procedure	22
2.5 Reporting	24
2.6 United Kingdom ("UK") FATCA.....	25
2.7 Intergovernmental Agreements ("IGAs")	25
2.8 OECD Common Reporting Standard	27
2.9 Sub conclusion	27
3 Drivers of the inconsistencies between the FATCA Final regulations and IGAs	30
3.1 Introduction	30
3.2 How legislative history and policy concerns shaped the FATCA final regulations	30
3.3 How legislative history and policy concerns shaped the IGAs	31
3.4 Key elements that ensured the different approach towards the FATCA final regulations and the IGAs	32
3.5 Drivers for the existence of two Model IGAs	34
3.6 Sub conclusion	34
4 Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to FFI classification?	35
4.1 Introduction	35
4.2 The classification of holding companies and treasury centers as FFIs	35
4.3 The interpretation of the term substantial US versus controlling person.....	38
4.4 The definition of an investment entity	40
4.5 Sub conclusion	43
5 Which inconsistencies exist between the final regulations, the Netherlands and the UK IGA with respect to due diligence and reporting?.....	45
5.1 Introduction	45
5.2 Due diligence	46
5.3 Inconsistencies with respect to due diligence.....	46
5.4 Inconsistencies with respect to Reporting	47
5.4.1 Reporting deadline	47
5.4.2 Reporting method.....	48
5.4.3 Nil returns	49
5.5 Sub conclusion	50

6 Industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs.....	51
6.1 Introduction	51
6.2 Education and outreach.....	51
6.3 Lack of guidance.....	53
6.4 Monitoring	55
6.5 US citizenship renunciation	56
6.6 Sub conclusion	57
7 Solutions that will address the industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs	59
7.1 Introduction	59
7.2 Bilateral vs. multilateral	59
7.3 Cooperation between US Treasury and stakeholders.....	61
7.3.1 Education and outreach	62
7.3.2 Monitoring.....	62
7.3.3 Lack of guidance	63
7.4 Implementing deadlines for guidance under local law.....	64
7.5 FATCA Committee.....	65
7.6 Transitional rules	66
7.7 Sub conclusion	67
8 Conclusion	69
8.1 Introduction	69
8.2 Addressing the key questions.....	70
8.2.1. What are the drivers of the inconsistencies between the FATCA final regulations and IGAs? 70	
8.2.2 Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the FFI classification?	70
8.2.3 Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the due diligence and reporting?	72
8.2.4 What industry challenges are financial institutions and other in scope entities facing as a result of these inconsistencies?	73
8.2.5. How can the challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?	74
8.3 Addressing the central question.....	74
8.3.1 FATCA committee	75
8.3.2 Transitional rules	75
Literature list.....	76
Annex A.....	77
Interview Michael Plowgian	77
Interview Deirdre Joyce	82
Interview Benno Oldenhof	87
Interview Bradford Labonte.....	91

LIST OF ABBREVIATIONS

The following table describes the significance of the various abbreviations and acronyms used throughout the thesis.

AI	Alternative Investments
AML	Anti-Money Laundering
CRS	Common Reporting Standard
EAG	Expanded Affiliated Group
FATCA	Foreign Account Tax Compliance Act
FFI	Foreign Financial Institution
FI	Financial Institution
HIRE	Hiring Incentives to Restore Employment Act
IGA	Intergovernmental Agreement
IRC	Internal Revenue Code
IRS	Internal Revenue Service
KYC	Know Your Customer
LLP	Limited Liability Partnership
NFFE	Non-Foreign Financial Entity
PFFI	Participating Foreign Financial Institutions
RO	Responsible Officer
TD	Treasury Decisions
TIEA	Tax Information Exchange Agreement
UK CDOT	United Kingdom Crown Dependencies and Overseas Territories
UK	United Kingdom
US	United States

INTRODUCTION

The Foreign Account Tax Compliance Act (“FATCA”) was enacted on March 18, 2010, as part of the Hiring Incentives to Restore Employment Act.¹ FATCA is an information-reporting regime that went into effect on July 1, 2014. FATCA aims to combat tax evasion and improve global tax compliance.

This initiative aims to combat tax evasion by identifying US persons with accounts offshore via a set of due diligence, reporting and withholding obligations. The FATCA final regulations provide for a phased implementation of the FATCA requirements. The FATCA requirements apply to Foreign Financial Institutions (“FFIs”) and certain Non-Financial Foreign Entities (“NFFEs”).

FFIs and certain NFFEs are subject to the following FATCA requirements:

1. Identification of account holder²;
2. Collect necessary US tax documentation to determine account holder’s status³;
3. Validate US tax documentation⁴;
4. Continuously monitor US tax documentation⁵;
5. Report to the IRS on an annual basis⁶;
6. Appoint a Responsible Officer (“RO”) ⁷;
7. Withholding on US source withholdable payments made to nonparticipating FFIs.⁸

The FATCA requirements will be discussed in detail in this report.

The FATCA regime consists of the FATCA final regulations and the Intergovernmental Agreements (“IGAs”). IGAs are Tax Information Exchange Agreements (“TIEAs”) with partner jurisdictions which require partner jurisdictions to exchange tax information (bilateral agreements). The IGAs were developed to support the global implementation of FATCA by providing certain relief to partner jurisdictions and by removing legal barriers that would otherwise hamper the transfer of such data.

Treasury developed two IGAs, a Model 1 IGA and a Model 2 IGA. Under a Model 1 IGA, FFIs directly report US account information to the local tax authority, followed by the automatic exchange of information on a government-to-government basis with the IRS. The Model 1 IGA consists of two separate Model IGAs: a Model 1A and a Model 1B IGA. Model 1A is a reciprocal IGA and Model 1B is a non-reciprocal IGA. Reciprocal means that the US is required to provide specific information about residents of the Model 1 jurisdiction to the tax authorities of that Model 1 jurisdiction, in exchange for the information that the Model 1 jurisdiction provides to the US.

Under a Model 2 IGA, a FFI would directly report information with respect to US account holders to the IRS according to the FATCA final regulations. Currently there are more than 60 jurisdictions that have entered into IGAs with the US.⁹ The Model 1 and Model 2 IGAs do not include certain crucial information with respect to the FATCA requirements. The IGAs do not provide information with respect to the reporting deadline and reporting method. Since the IGAs do not include all the necessary information with respect to the FATCA requirements, partner jurisdictions FFIs and NFFEs rely on guidance notes in order to comply with these requirements. The Model 1 IGA stipulates that matters not discussed in the IGA can

¹ Public Law 111-147 2010/03, 124 stat. 71.

² Treasury Regulations §1.1471-3(b)

³ Treasury Regulations §1.1471-3(d)

⁴ Treasury Regulations §1.1471-3(c)

⁵ Treasury Regulations §1.1471-3(c)

⁶ Treasury Regulations §1.1471-4(d)

⁷ Treasury Regulations §1.1471-4(f)(2)(i)

⁸ Treasury Regulations §1.1471-4(a)(1)

⁹ ‘FATCA-Archive’, US Department of Treasury 23 March 2015, www.treasury.gov (search for FATCA-Archive).

be interpreted under local law. This means that partner jurisdictions under a Model 1 IGA are afforded, to some extent, flexibility in shaping the IGAs and provide guidance to their convenience. The aforementioned has led to different versions and interpretations of the IGAs. This does not apply under a Model 2 IGA since FFIs and NFFEs under a Model 2 IGA refer to the FATCA final regulations for guidance.

PROBLEM STATEMENT

The Model 1 and Model 2 IGA leaves out crucial information with respect to the reporting deadline, reporting method, local country registration requirements, etc. The IGAs also lack detail with respect to some crucial definitions. The lack of guidance in the IGAs leaves room for misinterpretation which can lead to errors and noncompliance. Information not discussed in the IGAs are left to be defined in the local countries' guidance notes. This means that FFIs and NFFEs under a Model 1 IGA greatly rely on guidance notes in order to comply with the FATCA requirements. The aforementioned only applies to Model 1 IGAs since Model 2 IGAs rely on guidance from the FATCA final regulations. Since the Model 1 IGAs state that matters not discussed in the IGAs can be interpreted under local law, partner jurisdictions have taken their own approach towards implementing FATCA. The flexibility to shape the IGAs and guidance to some extent, has led to different versions and interpretations of the IGAs.

The different versions of the Model 1 IGAs have resulted in inconsistencies among the IGAs and between the FATCA final regulations and the IGAs. The notable inconsistencies between the FATCA final regulations and the IGAs are with respect to FFI classification, investment entity classification, due diligence, and reporting. The scope of FATCA is very complex and complying with FATCA requirements is time consuming and costly. The inconsistencies increase administrative and financial burdens for international funds because they must comply with the different rule sets from various partner jurisdictions.

As mentioned before, partner jurisdictions FFIs and NFFEs rely on guidance notes from foreign governments to direct in the compliance of FATCA requirements. However, guidance notes do not provide sufficient information to the extent that inconsistencies between the FATCA final regulations and the IGAs have emerged potentially affecting IGAs performance. Approximately 75% of partner jurisdictions have not yet published guidance notes. In some cases partner jurisdictions have published some sort of guidance, but the guidance does not remove all the grey areas that exist. One such country is the Netherlands. The lack of guidance in partner jurisdictions delays the implementation of FATCA in partner jurisdictions. To date, the jurisdiction that has been most cooperative towards implementing FATCA into local law has been the United Kingdom ("UK").

The UK was one of the early adopters of FATCA. The UK entered into a Model 1A IGA in December 2012. Shortly after the UK signed the IGA, it published its guidance notes. The UK guidance notes is very detailed and removes many grey areas. These guidance have been extremely helpful for UK FIs and NFFEs. The UK guidance was so descriptive that many other partner jurisdictions modeled their guidance notes based on the UK guidance.

The Netherlands entered into a Model 1A IGA in December 2013. Unlike the UK, the Netherlands published its guidance notes a year after having signed the IGA, in January 2015. The guidance notes were published a week before the local reporting deadline. The Netherlands guidance lacks a detailed description, and was only published in Dutch. The Dutch guidance provides insufficient detail with respect to reporting. This created many grey areas for Netherlands FIs and NFFEs. Due to the lack of guidance with respect to reporting, a number of Dutch FIs were not able to comply on time with their reporting requirements.

The following example illustrates the general lack of guidance in the Netherlands and the implications for Netherlands FIs. The reporting deadline for Dutch FIs was January 30, 2015. The first draft of the guidance notes was released on January 23, 2015. The guidance does not include language with respect to the reporting deadline, reporting method, nil returns, penalty for late filing or filing extensions.

This lack of guidance delayed the phased implementation of FATCA in the Netherlands because FFIs and NFFEs do not have sufficient information to comply with their reporting requirements. Therefore, they were unable to correctly report thereby risking incurring penalties for noncompliance.

In light of one of the main industry challenges faced due to the inconsistencies between the FATCA final regulations and the IGAs, a comparative analysis of the FATCA final regulations will be conducted between the Dutch and the UK IGA. These two IGAs were chosen to illustrate the importance of guidance notes, and the potential consequences of lack of guidance inflicting undue burdens to FFIs and NFFEs. Both jurisdictions entered into a Model 1A IGA. This means that the jurisdictions opted for a reciprocal approach. Both IGAs were negotiated based on the same Model IGA. The inconsistencies among IGAs are the result of interpretation under local law. Thus, the selection of these two jurisdictions as case studies is premised on the notion that these two jurisdictions represent comparable conditions that could enrich the understanding regarding the inconsistencies among IGAs, as well as the industry challenges resulting from an inconsistent approach towards the FATCA final regulations and the IGAs.

The study, therefore, explores the drivers of the inconsistencies, the industry challenges that emerged due to the inconsistencies between the FATCA final regulations and the IGAs, and possible solutions to address industry challenges caused by these inconsistencies.

CENTRAL QUESTION AND KEY QUESTIONS

Throughout the research the following central question will be addressed:

How can the industry challenges caused by the inconsistencies between the FATCA final regulations and the IGAs be mitigated with respect to financial institutions, and other in scope entities that are active in jurisdictions with IGAs in effect?

The research will address the aforementioned central question. To properly address the central question the following key questions have been developed for a phased research process:

- (1) What are the drivers of the inconsistencies between the FATCA final regulations and IGAs?
- (2) Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to FFI classification?
- (3) Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to due diligence and reporting?
- (4) What industry challenges are faced by financial institutions and other in scope entities as a result of the inconsistencies between the FATCA final regulations and the IGAs?
- (5) How can the industry challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?

OBJECTIVE

The objective of this research is to provide FFIs and NFFEs with insights into:

- the drivers of the inconsistencies between the FATCA final regulations and the IGAs;
- the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA;
- the industry challenges that emerged as a result of these inconsistencies; and
- potential solutions to address these industry challenges.

Ultimately the objective is to have the article, which will be written based on the research, published in the KPMG newsletter, or another tax newsletter.

TARGET AUDIENCE

This research addresses the approach of Treasury towards FATCA, and the industry challenges that stem from this approach. The scope of FATCA and the FATCA obligations are not discussed in detail in this report. Therefore, to fully comprehend information discussed in this research report, it is assumed that the reader has some knowledge with regard to FATCA.

This research is written for FFIs, NFFEs, and tax advisors concerned with the approach of Treasury towards the FATCA regime.

CHAPTERS

This report consists of 8 chapters. Please see below for an overview of chapter one to eight:

- Chapter 1 addresses the methodical approach used for the research. This chapter elaborates on the research method and research strategy employed to address the key and central question(s).
- Chapter 2 discusses the theoretical framework of FATCA and the IGAs. This chapter also discusses the role of UK FATCA and the Common Reporting Standard (“CRS”) and the link of these initiatives with FATCA. CRS is included in this report because CRS’ approach will be discussed in the conclusion. The information discussed in this chapter is imperative to understand the scope of the research. This chapter mainly addresses FATCA’s obligations that will form part of the research. The FATCA requirements discussed in this chapter are based on the FATCA final regulations. The purpose of this chapter is to discuss and treat the information that will be analyzed throughout the research and provide the reader with a comprehensive basis for the research.
- Chapter 3 provides insights into the drivers of the inconsistencies between the FATCA final regulations and the IGAs. Research will be done into legislative history, policy concerns and Treasury’s approach towards FATCA. Interviews are held with FATCA experts to examine Treasury’s approach towards the IGAs. The results of the analysis will be discussed in this chapter. The purpose of this chapter is to discuss the drivers of the inconsistencies and provide the reader with insights with regard to Treasury’s inconsistent approach as it relates to the FATCA regime.
- Chapter 4 discusses the results of the comparative analysis between the FATCA final regulations, the Netherlands and the UK IGA with respect to FFI classification. The Netherlands and the UK IGA and guidance notes will be compared with one another and will address eventual inconsistencies. Each inconsistency identified through the comparative analysis will be discussed in this chapter. This chapter will not discuss the FFI classification process under the Netherlands and UK IGA. This chapter will solely address the specific inconsistencies. In certain cases part of the regulations in the IGAs have been cited to illustrate the specific inconsistency. The purpose of this chapter is to unearth inconsistencies with respect to FFI classification between the FATCA final regulations as they pertain to the Netherlands and the UK IGA.
- Chapter 5 discusses the results of the comparative analysis of the FATCA final regulations, the Netherlands and the UK IGA with respect to due diligence and reporting. The Netherlands and the UK IGA and guidance notes will be compared with the FATCA final regulations. The results of the analysis will be described in this chapter. This chapter does not address the due diligence and reporting process according to the Netherlands and UK IGA. This chapter will only address the specific inconsistencies. In certain cases part of the regulations in the IGAs have been cited to better illustrate the specific inconsistency. The purpose of this chapter is to identify and discuss the

inconsistencies with respect to due diligence and reporting between the FATCA final regulations and the Netherlands as well as the UK IGA.

- Chapter 6 addresses the industry challenges that emerged as a result from the inconsistencies between the FATCA final regulations and the IGAs. Examples will be used to illustrate industry challenges. Examples will be used based on different partner jurisdictions IGAs, such as the Netherlands, the UK, Denmark and Singapore. The challenges and examples noted in this chapter are based on information obtained from the field research. The purpose of this chapter is to illustrate industry challenges by way of examples. Examples are provided to make this chapter more comprehensive for the reader.
- Chapter 7 will discuss solutions to address industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs. The solutions discussed in this chapter will be examined with respect to their feasibility. The feasibility of the solutions will be tested through interviews with FATCA professionals. The purpose of this chapter is to develop a tool or a mechanism that will address the industry challenges discussed in chapter 6.
- Chapter 8 consists of a conclusion of the research. This chapter will address the central question and the key questions described in the introduction. The potential solutions addressing industry challenges will be compared to each other and the adequacy of each solution will be examined through the lens of its feasibility derived from the field interviews. Chapter 8 forms the core of the research as it will answer the central question.

LIMITATION

In order to develop a research report that addresses the key questions, the information provided will be limited to the inconsistencies with respect to FFI classification, due diligence and reporting. Note that the FATCA final regulations and the IGAs also contain other definitions with respect to entity classifications, which include, among others, registered deemed-compliant financial institution, certified deemed-compliant financial institution, owner-documented financial institution. However, these items will not be covered in this research report.

This report will specifically focus on the inconsistencies with respect to FFI classification, due diligence and reporting, the industry challenges that emerged as a result of these inconsistencies and a solution that will address the industry challenges. The research will consist of a comparative analysis of the FATCA final regulations, the Netherlands, and the UK IGA and an exploration of the drivers and industry challenges that have emerged as a result of these inconsistencies. The Netherlands and UK IGA were chosen intentionally to illustrate the one of the biggest industry challenges.

FINAL PRODUCT

The results of the research will be discussed in the research report. The final products will consist of a research report and an article. The article will be based on the results of the research report. The article will specifically address the drivers of the inconsistencies between the FATCA final regulations and the IGAs, the industry challenges that have emerged as a result of these inconsistencies, and potential solutions to address the industry challenges. The objective is to contribute to market efficiency and reduction of market friction by providing FFIs and NFFEs with meaningful information and insights into aspects of the FATCA regime.

EXPERTISE

This report is the result of desk research as well as field research. Desk research includes literature search and law research. The field research includes open interviews conducted with FATCA experts,

and observations made during practical research. Practical research includes work experience on FATCA engagements. FATCA engagements include, the technical and interpretive analysis of the FATCA final regulations, and the IGAs, and the development of FATCA tools to facilitate the implementation of FATCA for multinational corporations.

1 METHODOLOGICAL FRAMEWORK

1.1 INTRODUCTION

This chapter describes the methodological approach of the research process. The research strategy, research method and the resources used throughout the research will be discussed in this chapter. In order to properly answer the central question, key questions have been developed for a phased research process. The research strategy and research method will be discussed per key question. Emphasis will be put on the content validity and reliability of the resources used in the research.

1.2 RESEARCH STRATEGY

This paragraph will address the research strategy that was used to answer the key questions and the central question.

This research report is based on a practical legal research. Research was done into the inconsistencies stemming from the FATCA final regulations as they are applied to the Netherlands and the UK IGA. In addition, research was conducted into industry challenges that emerged from these inconsistencies. The Netherlands and UK IGA were chosen as part of the research to illustrate the inconsistent implementation of FATCA under local law as well as to illustrate one of the main industry challenges faced to date due to FATCA's inconsistent approach. The extent of lack of guidance under local law and its impact was examined in the Dutch and UK case studies.

In order to correctly address the central question, key questions were developed to facilitate the research process. The scope of each key question was different, and each key question required a different research approach. Throughout the research process research was done into the theoretical scope of the inconsistencies. This included legislative history and policy concerns, a comparative analysis of the FATCA final regulations and the Netherlands and the UK IGA, and the challenges for FFIs and NFFEs due to these inconsistencies. The key questions were addressed by conducting a desk research and a field research. The desk research included literature and legal research, while literature research covered relevant tax articles and FATCA publications. Legal research consisted of research into the FATCA final regulations, the IGAs, guidance notes, legislative history and policy concerns. A comparative analysis was performed of the FATCA final regulations, the Netherlands, and the UK IGA in order to scan and identify inconsistencies among these regulations.

The field research formed part of the practical research. The field research consisted of open interviews with FATCA experts and observations based on work experience.

Throughout this research qualitative and quantitative research methods were used in order to gather the information needed to address the key questions.

The qualitative research method was employed to address key questions 1, 2, 3, 4 and 5. Qualitative research was done into Treasury's bilateral approach towards FATCA and the IGAs as well in detecting the drivers of the inconsistencies between the FATCA final regulations and the IGAs. In addition, qualitative research examined industry challenges that emerged from the inconsistencies and provided direction of what were required for addressing industry concerns. Methods referencing qualitative research includes, literature research, case study, and field research.¹⁰

The quantitative research was used to address key question 5. A quantitative research method is a method where data gathered are measured. In order to address key question 5, the feasibility regarding potential solutions was tested by measuring these proposed solutions through interviews with FATCA

¹⁰ Van Schaaijk, G, *Praktijkgericht Juridisch Onderzoek*. Page 79

experts. The feasibility was tested by asking FATCA experts whether the proposed solutions were practical and feasible. Methods referencing quantitative research included experimental research, survey research, and monitoring. Monitoring was used to address key questions 4 and 5. As FATCA is a moving target, regulations are constantly changing. This requires the continuous monitoring for legislative updates. Data gathered from the interviews were measured in order to come up with the most practical solution to address industry concerns that emerged as result of inconsistencies between the FATCA final regulations and the IGAs.

Research strategies will be discussed in greater detail below.

Law research

With respect to law research, the following desk research strategies were used to discuss the theoretical scope of FATCA: legislative history, policy concerns, legislative updates, the FATCA final regulations and the IGAs. The data obtained from the abovementioned research strategies were analyzed, compared and processed into the research report. As part of the desk research law, literature, and paper search was done.

Practical research

The research strategy that was used with respect to the practical research is a field research. The field research consisted of open interviews with FATCA experts and observations from work experience. As part of the research, the graduate candidate formed part of the KPMG FATCA team and worked on numerous FATCA engagements. These engagements consisted of technical and interpretive analysis of FATCA final regulations and the IGAs. Interviews were held with four FATCA experts. The majority of the interviews were held with senior managers, managing directors and partners. Because of the complexity of the FATCA regime, FATCA experts in the aforementioned positions would be in the best position to provide meaningful information. Four interviews were held to assure the accuracy and reliability of the data provided in this report. Throughout the research project four FATCA experts were interviewed:

- Michael Plowgian

Michael Plowgian is currently an international tax principal at KPMG Washington National Tax. Michael is a former government official and one of the drafters of the FATCA final regulations and the IGAs.

- Deirdre Joyce

Deirdre Joyce is an international tax senior manager at KPMG LLP. Deirdre primarily works on FATCA engagements. Deirdre is a highly skilled professional with multiple years of experience working on FATCA engagements.

- Benno Oldenhof

Benno Oldenhof is a tax partner at Baker Tilly in Aruba. Benno has years of experience working on FATCA engagements dealing with FFIs and NFFEs in the Caribbean.

- Brad Labonte

Brad Labonte is an international tax associate at KPMG LLP. Brad forms part of the KPMG FATCA team and has numerous years of experience with FATCA.

The abovementioned interviewees were deliberately chosen due to their expertise and experience working as members of the KPMG FATCA team, with the exception of Benno Oldenhof. The choice to interview Benno Oldenhof was based on the research strategy. Receiving information from sources that are independent from each other further assures content validity and reliability. Benno Oldenhof is a source that is independent from KPMG and the information gathered from him can be cross validated with KPMG interviews.

Interview questions were based on specific information required to address key question 1, 4 and 5. The interview included specific inconsistencies questions and questions on Treasury's approach towards the FATCA regime. Some questions were intended to garner insights into Treasury's governmental approach towards FATCA. The other questions were intended to receive the interviewee's views on the inconsistencies and the industry challenges that emerged therefrom. In addition, the interviewer suggested solutions addressing industry challenges to interviewees in order to get their opinion with regard to the feasibility of these solutions.

The interviews were held in person or through conference calls. Thus, the interviewer had direct interaction with the interviewees. This facilitated the interview process since the interviewer was able to further elaborate on certain questions. This assured a successful interview because the interviewer was able to receive all the information needed from these resources.

Part of the research plan was to interview another FATCA drafter and another FATCA expert. The FATCA expert intended to be interviewed was David Richardson, while the other principal FATCA drafter was Manal Corwin. Unfortunately, these interviews were not realized because the interviewer was unable to get in contact with the aforementioned interview candidates.

1.3 RESOURCES AND RESEARCH METHODS

The resources used throughout the research project were mainly law resources, tax articles, tax publications, observations and information gathered from interviews. The interviewees were FATCA experts deliberately chosen to provide accurate and reliable information.

The research method is described below, according to each key question of the research project:

1. What are the drivers of the inconsistencies between the FATCA final regulations and IGAs?

The research methods used to address the first key question were both desk research and field research. The desk research was done by conducting literature and legal research. Research was done into legislative history, the FATCA final regulations, and relevant tax articles.

As part of the field research, open interviews were held with FATCA experts. In order to correctly address this key question, research was done into the drivers of the inconsistencies. Michael Plowgian provided valuable information with regard to the inconsistencies, particularly referencing his experience when drafting the FATCA regulations. The results of the interview were processed into this report.

2. Which inconsistencies exist between the FATCA final regulations and the Netherlands and UK IGA with regard to FFI classification?

The research method used to address this key question was desk research. Literature and legal research was done to identify the inconsistencies. Law resources were used to address this key question such as the FATCA final regulations, the Netherlands and the UK IGA. The Netherlands and UK guidance notes were also used. These three regulations were compared to each other. In addition, KPMG internal websites were used to monitor legislative updates with respect to the FATCA final regulations and the IGAs. The results of the analysis were processed in this report.

3. Which inconsistencies exist between the FATCA final regulations and the Netherlands and UK IGA with regard to due diligence and reporting?

Literature and legal research were conducted to identify the inconsistencies. Law resources employed to address this key question were the FATCA final regulations, the Netherlands and the UK IGA. The Netherlands and UK guidance notes were also examined. These three regulations were again compared to each other. In addition, KPMG internal websites were used to monitor legislative updates with respect to the FATCA final regulations and the IGAs. The results of the analysis were revealed in this report.

4. *What industry challenges are financial institutions and in scope entities facing as a result of the inconsistencies between the FATCA final regulations and the IGAs?*

The research method used to address this key question was field research. Open interviews were held with FATCA experts and observations were made through field work. A minimum of four interviews were held with FATCA experts in order to discuss industry challenges experienced while working on FATCA engagements. Throughout the research process, the graduate candidate formed part of the KPMG FATCA team and received the opportunity to engage in numerous FATCA projects. The graduate candidate made observations with respect to industry challenges that FFIs and NFFEs were facing while being engaged in FATCA projects. These observations are documented in this report. In order to comply with KPMG confidentiality agreement, company names and specific company information are not disclosed. The examples provided are only intended to strengthen and confirm arguments.

5. *How can the industry challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?*

The research method used to address this key question was a combination of desk and field research. Desk research was done to gather information and to create a mechanism to address industry issues discussed in key question 4. The feasibility of the solutions were tested during the interviews with FATCA experts. The results of the interviews determined the solutions to address the inconsistency issues, which hopefully may mitigate the unnecessary burdens placed upon FFIs and NFFEs.

1.4 METHODOICAL JUSTIFICATION

The strategy employed in this research process was guided by effective design, methods and procedures. Consequently, desk research addressed question one, while open interviews and observations took care of questions 4 and 5, realizing four interviews with experts in the field. Where necessary, information gathered from the interviews was complemented with desk research. Interviews are essential resources as these resources assure the content validity and reliability of the information provided in this report. Content validity and reliability were further enhanced through research process law resources as well through the interview with Michael Plowgian, one of the FATCA drafters. Information gathered from the interviews with FATCA experts further enhanced field observations and interpretation of the identified inconsistencies and potential solutions.

2 FOREIGN ACCOUNT TAX COMPLIANCE ACT (“FATCA”)

2.1 INTRODUCTION

This chapter describes the theoretical framework of FATCA, the Intergovernmental Agreements (“IGAs”), the UK FATCA program and the Common Reporting Standard (“CRS”). The regulations discussed in this chapter are based on the FATCA final regulations.

This chapter addresses:

- the goal of FATCA;
- the FATCA requirements;
- the information to be reported under FATCA;
- the reporting obligations;
- the FATCA entity classification;
- the due diligence obligations;
- the goal and scope of the IGAs;
- the Netherlands and the UK IGA;
- the link with OECD Common Reporting Standard.

This chapter is intended to provide the reader with insight into the theoretical scope of FATCA and the IGAs. This chapter also discusses the link between the FATCA final regulations and the IGAs, the UK FATCA and CRS. This chapter is an introductory chapter that will provide the reader with enough material to understand the research that will be discussed in the following chapters.

The information revealed in this chapter will be used for the comparative analysis among the FATCA final regulations, the Netherlands and the UK IGA. CRS was included in this report since certain components of CRS will form part of the conclusion. UK FATCA was included in this report to illustrate the support of the UK towards implementing FATCA under local law, and to inform the reader about the relevance in distinguishing UK FATCA and the UK IGA. These regimes form part of two different information reporting systems. The italic font is used to illustrate certain law citations.

2.2 FATCA FINAL REGULATIONS

FATCA, was enacted in 2010 by the Hiring Incentives to Restore Employment Act. FATCA was enacted by the US Congress to prevent offshore tax abuses by US persons. The FATCA final regulations went into effect on July 1, 2014.

FATCA is an information-reporting regime that identifies US persons with accounts offshore. IRS and US Treasury aim to achieve global tax-compliance and to minimize tax-evasion through identifying US taxpayers via a set of due diligence, reporting and withholding obligations.¹¹ These FATCA obligations are required to be carried out by FFIs and NFFEs. The US Treasury Department assumes that FFIs and certain NFFEs are in the best position to identify and accurately report tax-relevant information to the IRS with respect to their US customers and investors. FATCA requirements are based on FATCA status. FATCA status of an entity is determined by a fact and circumstance test¹² in establishing the entity type. Generally, FATCA distinguishes two entity types, a FFI and a NFFE.¹³ This means that FATCA

¹¹ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

¹² FATCA entity classification

¹³ FATCA entity classification includes, but it not limited to, FFI and a NFFE.

requirements depend on whether an entity is a FFI or a NFFE. Generally, FFIs are subject to more FATCA obligations than NFFEs.

To determine whether an entity is a FFI, a FFI classification test must be done. An entity falls within the scope of a FFI if it is a depository institution, custodial institution, investment entity, specified insurance company or holding and treasury center. The scope of a FFI will be discussed further in greater detail in this chapter.

If an entity does not fall within the scope of a FFI it is a NFFE. The NFFE test will be discussed later in this chapter.

Once an entity has determined its FATCA status, it will also know the FATCA requirements that it should comply with.

FATCA aims to increase the IRS' ability to identify¹⁴:

- US taxpayers who hold money, assets, and income earned in financial accounts held by FFIs, and
- US taxpayers who've earned income through investments in foreign investment funds or through other similar offshore investment products.

The identification of US taxpayers is done by conducting due diligence on their account holders and by reporting specific US tax information of certain US customers and US investors to the IRS. Due diligence is the procedure that takes place to scan for any US indicia.

The information that needs to be exchanged with respect reportable accounts according to the FATCA final regulations include¹⁵:

- The account holder's (individual or entity) name, address and US TIN,
- The account number,
- The account balance or value, and
- The payments made with respect to that account.

Investors that do not comply with FATCA requirements will be subject to a 30% withholding tax on withholdable payments.¹⁶ In case of noncompliance, FFIs and certain NFFEs are required to withhold on payments made to noncompliant/non-cooperative investors.¹⁷ Withholdable payments are certain payments received from US sources, which generally include interest paid on bonds, dividends paid on US equities, notes, bills, debt of US issuers, and gross proceeds. Withholding agents are responsible for withholding the 30% withholding tax penalty on payments made to noncompliant/non-cooperative investors. All US or foreign persons making a payment subject to FATCA, fall under the scope of a withholding agent.¹⁸ If a withholding agent fails to comply with its requirement to withhold, than the withholding agents itself is subject to the 30% withholding tax penalty.

The FATCA final regulations were drafted and published by the US Treasury Department. FATCA is a set of complex regulations which includes, Treasury Regulations, Treasury Decisions ("TD"), and IGAs. IGAs are agreements between the US government and partner jurisdiction to implement FATCA. Every IGA is country specific and unique and provides certain relief with respect to FATCA requirements.¹⁹ The scope of the IGAs will be discussed in greater detail in chapter 2.7.

¹⁴ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

¹⁵ Treasury Regulations §1.1471-4(d)(3)

¹⁶ Treasury Regulations §1.1471-2(a)(1)

¹⁷ Treasury Regulations §1.1471-4(a)(1)

¹⁸ Treasury Regulations §1.1473-1(d)(1)

¹⁹ Treasury Regulations §§1.1471-1.1474, Preamble, Explanation of Provisions, II.H.

2.3 ENTITY CLASSIFICATION

Entity classification is the first step in determining the FATCA requirements that apply to a respective entity. According to the FATCA final regulations, all FFIs and certain NFFEs must identify the status of their investors to determine whether any US status is found and whether reporting is required.

Identifying the status of funds investors is an important step because the FATCA status determines whether an entity is subject to FATCA's due diligence and reporting requirements. Failure to properly identify these investors may result in exposure to the 30% withholding tax.

The FATCA final regulations provides that certain information with respect to reportable accounts must be reported to the IRS on an annual basis. In order to identify reportable accounts, entities must be assigned a FACTA status, which includes but is not limited to FFI, NFFE, or Specified US person.²⁰

In assigning a FATCA classification to an entity, the entity must be tested to determine whether it is a FFI or NFFE. The entity classification test consists of a FFI classification test and a NFFE test. Where an entity does not meet any of the criteria to qualify as a FFI, it will be considered an NFFE. The FFI and NFFE classification test will be discussed below.

FFI Classification

To classify as a reportable account, the account must be held by a financial account holder. A financial account means an account held by a FFI. Therefore, the first step in the entity classification process is to determine whether the entity classifies as a FFI. The FFI classification consists of a fact and circumstance analysis to determine whether an entity falls within the scope of a FFI.

Under the FATCA final regulations a FFI means a:

1. *Depository Institution.*²¹ A depository institution “means any entity that accepts deposits in the regular course of a banking or similar business.”²²
2. *Custodial Institution.*²³ A custodial institution “means any entity that holds, as a substantial portion of its business, financial assets for the account of others. An entity holds financial assets for the account of others as a substantial portion of its business if the entity’s gross income attributable to the holding of financial assets and related financial services equals or exceeds 20 percent of the entity’s gross income during the shorter of: (i) the three year period that ends on December 31 (or the final day of a non-calendar year accounting period) prior to the year in which the determination is being made; or (ii) the period during which the entity has been in existence.”²⁴
3. *Investment Entity.*²⁵ An investment entity means:
 - (A) “any entity that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:
 - (1) Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
 - (2) Individual and collective portfolio management; or

²⁰ FATCA entity classification is not limited to a FFI, NFFE or a Specified US person, however, this report will not discuss the other FATCA classifications as this is not relevant to the analysis.

²¹ Treasury regulations §1.1471-5(e)(1)(i)

²² Treasury regulations §1.1471-5(e)(2)

²³ Treasury regulations §1.1471-5(e)(1)(ii)

²⁴ Treasury regulations §1.1471-5(e)(3)

²⁵ Treasury regulations §1.1471-5(e)(1)(iii)

- (3) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*
- (B) *The entity's gross income primarily attributable to investing, reinvesting, or trading in financial assets, and the entity is managed by another entity that is a financial institution. An entity is managed by another entity that is a financial institution if the managing entity performs either directly or through a third party service provider, any of the activities mentioned in (A).*
- (C) *The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.*"²⁶
4. *Specified Insurance Company.*²⁷ *A specified insurance company "means any entity that is an insurance company (or the holding company of an insurance company) that issues, or is obligated to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract."*²⁸
5. *Holding company and treasury center.*²⁹ *An entity is classified as a holding company if its primary activity is the holding (directly or indirectly) of all or part of the outstanding stock of one or more members of its expanded affiliated group ("EAG"). "A partnership or any other non-corporate entity will be treated as a holding company if substantially all the activities of such partnership consist of holding more than 50% of the voting power and value of the stock of one or common parent corporation(s) of one or more expanded affiliated group"*³⁰.³¹

*An entity is classified as a Treasury Center if its primary activities consists of entering into investment, hedging, and financing transactions with or for members of its expanded affiliated group for purposes of*³²:

- (i) *Managing the risk of price changes or currency fluctuations with respect to property that is being held or will be held by the expanded affiliated group*
- (ii) *Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to borrowings made or to be made by the expanded affiliated group*
- (iii) *Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to assets or liabilities to be reflected in financial statements of the expanded affiliated group*
- (iv) *Managing the working capital of the EAG such as by cash pooling the balances of affiliates or by investing or trading in financial assets only for the risk of such entity or any members of its expanded affiliated group*
- (v) *Acting as a financial vehicle for the expanded affiliated group*

When an entity falls within the scope of a FFI, the financial accounts are considered reportable accounts. Reportable accounts have the following FATCA requirements:

8. *Identification of payee.*³³ *A FFI must identify US accounts by obtaining necessary documentation to determine if the account holder has US indicia. The first step is to determine whether the FFI*

²⁶ Treasury regulations §1.1471-5(e)(4)

²⁷ Treasury regulations §1.1471-5(e)(1)(iv)

²⁸ Treasury regulations §1.1471-5(e)(5), §1.1471-5(e)(1)(iv)

²⁹ Treasury regulations §1.1471-5(e)(5)(i)(C), §1.1471-5(e)(5)(i)(D)(1)

³⁰ Treasury regulations §1.1471-4(e)(1)

³¹ Treasury regulations §1.1471-5(e)(5)(i)(C)

³² Treasury regulations §1.1471-5(e)(5)(i)(D)

³³ Treasury Regulations §1.1471-3(b)

has any US account holders. Identification of US account holders will be done through an IRS-specified due diligence process. In order to meet the requirements, know your customer (“KYC”) and Anti-money laundering (“AML”) processes can be used to identify target accounts.

9. Collecting necessary US tax documentation (IRS Form W-9/W-8 or self-certifications to the extent permitted) to determine account holder’s status. In certain cases tax documentation is also needed to dismiss certain funds from FATCA obligations.³⁴
10. Validating US tax documentation to ensure account holders FATCA status is reliable and accurate.³⁵
11. Continuously monitoring of US tax documentation to ensure that FATCA status of investors is accurate over time.³⁶
12. Reporting of FATCA information with respect to US accounts to the IRS on an annual basis.³⁷
13. Appointing a Responsible Officer (RO) who will notify the IRS periodically about the FFIs compliance and certifications.³⁸
14. Withholding on US source withholdable payments made to nonparticipating FFIs that have not acted in accordance with the FATCA final regulations and to recalcitrant accounts.³⁹

A FFI is required to register with the IRS on the FATCA registration portal⁴⁰, identify and document the FATCA status of each account holder maintained by the FFI. If the account is identified as a reportable account, then the FFI must annually report US reportable accounts to the IRS⁴¹.

NFFE test

When an entity does not fall under the scope of a FFI, that entity is defined as a NFFE. FATCA’s final regulations distinguish two types of NFFEs, Active NFFE and Passive NFFE. When an entity is a NFFE, it must perform the NFFE test to determine whether it is an Active or Passive NFFE.

Generally, an Active NFFE is a NFFE that meets the cumulative income and asset test. This test provides that less than 50% of the NFFEs gross income consists of passive income and less than 50% of the assets held by the NFFE during the calendar year consists of assets that produce or are held for the production of passive income. When an entity does not meet any of the criteria to qualify as an Active NFFE, it is considered a Passive NFFE. A NFFE does not have the same FATCA requirements as the FFI. Generally, only a Passive NFFE is required to conduct due diligence, identify substantial US owners, and report these US owners to the IRS. Substantial US owners are US persons with at least 10% owner ship interest in an entity. An Active NFFE does not have any reporting obligations.

2.4 DUE DILIGENCE PROCEDURE

Due diligence is the process that must take place in order to review investors, scan for US indicia and collect tax documentation from investors in order to establish FATCA status as an investor.

Due diligence consists of reviewing pre-existing and new individual as well as entity accounts, and includes reviewing their FATCA status in search for any US indicia (i.e., US citizenship). A pre-existing account is an account opened before July 1, 2014. New accounts are accounts opened after July 1, 2014.

³⁴ Treasury Regulations §1.1471-3(d)

³⁵ Treasury Regulations §1.1471-3(c)

³⁶ Treasury Regulations §1.1471-3(c)

³⁷ Treasury Regulations §1.1471-4(d)

³⁸ Treasury Regulations §1.1471-4(f)(2)(i)

³⁹ Treasury Regulations §1.1471-4(a)(1)

⁴⁰ ‘FATCA FFI registration’, IRS January 2015, www.irs.gov (search for *FATCA registration*)

⁴¹ Treasury regulations §1.1471-4(c)(1) and §1.1471-4(c)(2)

Depending on which FATCA status is identified, the financial institution must collect specific tax documentation from the account holder to verify its claim to the FATCA status. Tax documentation includes among others, self-certification, Form W8, Form W9, and documentary evidence.

The review procedure of individual accounts consists of an electronic and paper record search. In most cases only the electronic search is necessary. The paper record search will be done if the FFI was not able to capture the data needed to establish whether the individual account has any US indicia.

Due diligence individual accounts

The due diligence procedure for pre-existing and new individual accounts consists of an electronic search for one of the following types of US indicia:

- a) Identification of the account holder as a US citizen or resident;
- b) Unambiguous indication of a US place of birth;
- c) Current US mailing or residence address (including a US post office box or US “in-care-of” address);
- d) Current US telephone number;
- e) Standing instructions to transfer funds to an account maintained in the United States;
- f) Currently effective power of attorney or signatory authority granted to a person with a US address; or
- g) An “in-care-of” or “hold mail” address that is the sole address the Financial Institution has on file for the account holder. In the case of a Pre-existing Individual Account that is a Lower Value Account, an “in-care-of” address outside the United States shall not be treated as US indicia.

With respect to pre-existing individual accounts, if the electronic search indicates any of the abovementioned US indicia types, the FFI must collect certain tax documentation to establish FATCA status, such as self-certification, W-8, passport, documentary evidence, etc.

With respect to new individual accounts, the FFI must obtain a self-certification from the investor within 90 days of account opening. This will allow the FFI to determine the account holder’s tax residency and whether the investor is a US citizen or resident for tax purposes. A FFI may rely on information collected pursuant to AML/KYC Procedures to support FATCA status claim of investors. If US indicia is found and the self-certification establishes account holder’s US residency, the account will be treated as a reportable account and the FFI must obtain a self-certification that includes the account holder’s US TIN (which may be an IRS Form W-9 or other similar agreed form).

Entity accounts

For the review procedure of entity accounts, FFIs are in search of account holders that are Specified US Persons or substantial US owners. Only entity accounts with a value higher than \$250,000 are accounts subject to review.

To identify entity accounts and determine whether the entity is a Specified US Person, the FFI must review information maintained pursuant to AML/KYC procedures to determine whether the information indicates that the entity account holder is a US Person. Information indicating that the entity is a US Person includes a US place of incorporation or organization, or a US address.

If the information indicates that the entity account holder is a US Person, the Reporting FFI must treat the account as a US Reportable Account unless it obtains a self-certification from the account holder (which may be on an IRS Form W-8 or W-9, or a similar agreed form), that the account holder is not a Specified US Person.

To determine the substantial US owner of an entity, the FFI may rely on information collected and maintained pursuant to AML/KYC procedures.

To determine whether the entity is a Passive NFFE, the FFI must collect a self-certification (which may be on an IRS Form W-8 or W-9, or on a similar agreed form) from the entity account holder to establish its FATCA status.

To determine whether a substantial US owner of a Passive NFFE is a US citizen or resident, a FFI may rely on:

- (1) Information collected and maintained pursuant to AML/KYC procedures
- (2) A self-certification (which may be on an IRS Form W-8 or W-9, or on a similar agreed form).

With respect to new entity accounts, a Reporting FFI must obtain a self-certification from the account holder to establish the account holder's status. If the entity account holder is a **Specified US Person**, the Reporting FFI must treat the account as a US Reportable Account.

If the entity account holder is a **Passive NFFE**, the Reporting FFI must identify the substantial US persons as determined under AML/KYC Procedures, and must determine whether such person is a US citizen or resident by obtaining a self-certification from the account holder. If any such person is a citizen or resident of the United States, the account shall be treated as a US Reportable Account.

US reportable accounts are required to be reported to the IRS.

Due diligence deadlines

There are different due diligences deadlines with respect to low and high value accounts. Individual and entity accounts that exceeds \$1,000,000, are considered high value accounts. The due diligence procedures for high value accounts are required to be completed by June 30, 2015.

Individual accounts that exceed \$50,000, but does not exceed \$1,000,000 as of June 30, 2014 are considered low value individual accounts. Entity accounts that exceed \$250,000 but does not exceed \$1,000,000 as of June 30, 2014, are considered low value entity accounts. The due diligence procedures for low value accounts are required to be completed by June 30, 2016.

The deadline for due diligence on new accounts is 90 days within account opening. This means that documentation must be obtained from account holder within 90 days of account opening.

2.5 REPORTING

The information provided above must be reported on FATCA Form 8966⁴². Form 8966 is based on the FATCA XML Schema. International organizations do not directly fill in form 8966, they fill in a XML schema which is subject to transmission. The XML schema is a specific excel based file where FFIs and NFFEs insert reportable information. Information will be reported via the XML schema to the IRS whereas the information in the XML schema will be automatically transmitted into Form 8966. Reporting must be done on or before March 31 of the year following the end of the calendar year to which the form relates.⁴³ On March 24, 2014, the IRS published an announcement regarding an automatic 90 day extension until June 29, 2015 for most filers.⁴⁴ This means that the deadline for reporting year 2014 is June 29, 2015. For reporting year 2015 and onwards the reporting deadline is March 31.

⁴² Treasury Regulations §1.1471-4(d)(3)(v)

⁴³ Treasury Regulations §1.1471-4(d)(3)(vi)

⁴⁴ Treasury Decision 9657

2.6 UNITED KINGDOM (“UK”) FATCA

Separate from the US FATCA and the UK IGA with the US, the UK has also implemented its own FATCA program (“UK FATCA,”). UK FATCA is also known as the UK Crown Dependencies and Overseas Territories (“CDOT”) program. Under this program, the UK has taken its own approach on FATCA and has implemented a regime very similar to US FATCA. With respect to UK FATCA, UK has entered into IGAs with its Crown Dependencies and Overseas Territories. These IGAs are based on the Model 1 IGA. The jurisdictions that form part of the Crown Dependencies and Overseas Territories are Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Montserrat, and Turks and Caicos. Funds located in an UK IGA jurisdiction are subject to UK FATCA. This means that they have an identification and disclosing requirement with respect to information of UK financial account holders and must report the information to HM Revenue & Customs (UK tax authority).

Note that US and UK FATCA are two separate regimes. Some countries are subject to both information-reporting regimes. For example, Cayman Islands and British Virgin Islands are subject to both regimes.

When analyzing the FATCA requirements of these countries, both regimes must be taken into account. This ultimately means that two due diligence process must be implemented, one to identify US account holders and the other to identify UK account holders.

2.7 INTERGOVERNMENTAL AGREEMENTS (“IGAs”)

In addition to the FATCA final regulations, the US Treasury Department has published Intergovernmental Agreements (“IGAs”) to support the implementation of FATCA in foreign jurisdiction. IGAs are bilateral agreements between governments to cooperate on the exchange of FATCA information of US taxpayers or taxpayers of partner jurisdiction to the IRS or to local tax authorities.

The IGAs have been introduced to enable the transfer of tax information to the IRS and to provide a method that allows partner jurisdictions to transfer account information by revising the relevant local regulations that would otherwise forbid the transfer of such data. This was necessary because certain jurisdictions have domestic laws that prevent the international exchange of information. This forms a legal barrier for the implementation of FATCA.

To date, the US has signed more than 60 IGAs with foreign jurisdictions.⁴⁵ The US Treasury has drafted two Model IGAs to support the global implementation of FATCA, a Model 1 IGA and a Model 2 IGA. All IGAs are based on these Model IGAs.

The Model 1 IGA was first published on July 26, 2012.⁴⁶ The Model 1 IGA requires partner jurisdictions to implement FATCA under local law and adopt its own regulations to gather the information required under the FATCA final regulations with respect to entity classification, due diligence and reporting.

Model 1 IGAs consists of 2 versions, a reciprocal and nonreciprocal version:

- Model 1A IGA is reciprocal, which implies that the US must gather and report information on an annual basis from US FIs with respect to information about partner jurisdiction account holders in exchange for information about US tax payers.
- Model 1B IGA is nonreciprocal, which implies that the US does not have to obtain and report information about partner jurisdiction account holders to the partner jurisdiction’s tax authority.

⁴⁵ ‘FATCA-Archive’, US Department of Treasury 23 March 2015, www.treasury.gov (search for *FATCA-Archive*).

⁴⁶ Treasury Regulations §§1.1471-1.1474, Preamble, Harmonization with IGAs, II.H.

FFIs located in jurisdictions with a Model 1 IGA in effect, must comply with the regulations as set forth in the Model 1 IGA. FFIs covered by Model 1 IGAs are required to identify and report US account information in accordance with regulations adopted by the partner jurisdiction. This means that partner jurisdictions must publish guidance notes to facilitate the implementation of the FATCA final regulations.

FFIs covered by Model 1 IGAs, that are in compliance with the identification and reporting obligations under the local laws, will be treated as having complied with the due diligence and reporting obligations under the FATCA final regulations. These FFIs only need to comply with the regulations and requirements under the Model 1 IGA and do not need to apply the FATCA final regulations additionally. Certain domestic laws provide the opportunity to elect to apply provisions under the FATCA final regulations. If such possibility is provided by the jurisdiction, it will be noted in an IGA.

The Model 2 IGA was published on November 14, 2012.⁴⁷ FFIs covered by a Model 2 IGA must comply with the rules set forth in the FATCA final regulations and must register and report US account information directly to the IRS. The Model 2 IGAs requires partner jurisdiction to direct partner jurisdictions FFIs to enter into a FFI Agreement with the IRS.

Thus, one Model IGA overrides the FATCA final regulations (Model 1) and the other supplements it (Model 2). Since the Model IGAs have been published, there have been many developments with respect to these IGAs. New IGAs are continuously going into effect and many countries have yet to publish their guidance notes, so it is important to monitor what agreements are in effect and if new guidance notes have been published because this can change what rules apply to a specific situation.

The Netherlands IGA

The Netherlands and the US entered into a Model 1A IGA on December 18, 2013.⁴⁸ The Model 1A IGA, is the Model IGA that provides for reciprocal treatment. This means that the Netherlands is required to identify and report US financial accounts held by Netherlands financial institutions. In exchange for the information provided about US accountholders in the Netherlands, the US must provide Netherlands with information about Netherlands taxpayers with accounts in the US. The Netherlands provides the option to rely on the FATCA final regulations for the interpretation of certain IGA definitions.⁴⁹ The Netherlands has published Dutch guidance with respect to FATCA on January 22, 2015.⁵⁰ The Netherlands announced in January that an English version of the Dutch guidance will be published soon, however to this date no additional guidance has been released.

The United Kingdom IGA

The United Kingdom has entered into a Model 1A IGA with the United States on September 12, 2012.⁵¹ The UK implemented a Model 1A IGA, a reciprocal approach to the implementation of FATCA. The HM Revenue & Customs (HMRC) has published guidance notes on August 28, 2014 with respect to the implementation of the International Tax Compliance Regulations 2014.⁵² These broad guidance notes provides clarifications and removes many grey areas.

To date many countries have not yet published guidance notes. Guidance notes facilitates the implementation of the FATCA requirements since the IGAs do not provide sufficient language to properly

⁴⁷ Id.

⁴⁸ Verdrag tussen het Koninkrijk der Nederlanden en de Verenigde Staten van Amerika tot verbetering van de internationale naleving van de belastingplicht en tenuitvoerlegging van de FATCA, 's-Gravenhage 18 December 2013, Trb.2014, 22.

⁴⁹ Kamerstukken II 2013/14, 33 985, nr. 3, p. 16.

⁵⁰ Id.

⁵¹ 'FATCA-Archive', US Department of Treasury 23 March 2015, www.treasury.gov (search for *FATCA-Archive*).

⁵² Implementation of the international tax compliance (United States of America) regulations 2014. Guidance notes, United Kingdom 28 August 2014.

comply. As a result many countries are following guidance published by other countries, in various cases countries are following UK guidance notes since these guidance notes are very detailed and specific.

2.8 OECD COMMON REPORTING STANDARD

The Common Reporting Standard, also known as global FATCA “GATCA” has been enacted in April 2013 by the OECD as the new standard of international information exchange. Common Reporting Standard has been developed in the co-operation of G20 countries and EU⁵³. The Common Reporting Standard was published in February 2014, inspired greatly by the intergovernmental effort for the implementation of FATCA. The Common Reporting Standard has been developed as an effort to combat tax evasion worldwide and to protect the integrity of local tax systems. Legislative history has contributed to the introduction of FATCA the same way as it has for CRS. In the preface of the Common Reporting Standard⁵⁴, the OECD states that the increasing investments offshore has facilitated tax evasion and that offshore tax evasion has become a serious problem for jurisdictions over the world⁵⁵. In an attempt to combat tax evasion, the OECD has endorsed the Common Reporting Standard as a key aspect for the co-operation of international information exchange between tax administrations. The Common Reporting Standard applies to all countries. The G20 made a call on all countries to adopt this new regime. A joint statement has been signed on March 19, 2014 which indicates that 44 countries will be adopt the regime as of December 31, 2015.

The Common Reporting Standard is based on multilateral agreements which will cover all institutions worldly. The multilateral approach to international information exchange is one of the biggest differences compared to FATCA. FATCA is based on bilateral agreements.

The OECD modelled the Common Reporting Standard FATCA and tried to leverage off FATCA when developing this standard. This was done in an attempt to try to reduce burdens for FFIs worldly. Since the Common Reporting Standard is modelled on FATCA, its scope is similar to FATCA. FATCA and the Common Reporting Standard have certain keen similarities and also certain differences. These will not be discussed in this report because it is not relevant to the analysis.

2.9 SUB CONCLUSION

This chapter discussed the key elements of the FATCA regime. These elements include the FATCA final regulations, the IGAs, and the FATCA obligations. The FATCA regime is very complex. FATCA has different obligations which include implementing onboarding processes in the business and performing entity classification tests. The requirements are difficult to understand. Many entities outsource the FATCA obligations.

This information-reporting regime went into effect on July 1, 2014. FATCA forms part of the global effort towards reaching global tax compliance. This initiative aims to combat tax evasion by identifying US persons with accounts offshore via a set of due diligence, reporting and withholding obligations.

In order to determine the FATCA requirements that apply to each entity, the entity must perform an entity classification to determine its FATCA status. The FATCA status ultimately determines which FATCA requirements apply. Therefor the FATCA entity classification is the first step in determining the FATCA requirements for each entity. The entity classification consists of a fact and circumstance analysis to

⁵³ Standard for automatic exchange of financial account information by OECD (15 July 2014), *Common Reporting Standard*

⁵⁴ Id.

⁵⁵ Standard for automatic exchange of financial account information by OECD (15 July 2014), *Common Reporting Standard*

determine whether an entity falls within the scope of a FFI or NFFE. If an entity falls within one of the below mentioned categories, the entity will be classified as a FFI.

According to the FATCA final regulations FFIs are:

- 1 depository institution;
- 2 custodial institution;
- 3 investment entity;
- 4 specified insurance company; and
- 5 holding and treasury center.

If an entity does not fall within the scope of one of abovementioned categories, the entity will classify as an NFFE. Whether the NFFE has any reporting obligations depends on whether it is an Active or Passive NFFE. When an entity does not meet any of the criteria to qualify as an Active NFFE, it is considered a Passive NFFE

If an entity falls within the scope of a FFI it is required to:

- perform due diligence to identify US specified persons
- report US specified persons to the IRS,
- document its FATCA status

An Active NFFE has the following FATCA requirements:

- perform due diligence to identify US specified persons
- document its FATCA status

A Passive NFFE is required to:

- perform due diligence to identify US substantial owners
- report US substantial owners to the IRS.
- document its FATCA status

FATCA reporting is done on Form 8966. The information to be reported to the IRS includes, account holder's name, account number, account balance, and payments made to that account.

The reporting deadline is March 31 for reporting year 2015 and onwards. The reporting deadline for reporting 2014, is June 29, 2015 for most filers.

As mentioned before US persons will be identified through conducting due diligence procedures.

Due diligence is the process that must take place in order to review investors and scan for US indicia. This process also enables FFIs and certain NFFEs to establish the FATCA status of their investors.

The due diligence procedure to scan for US indicia consists of an electronic and paper record search.

There are different due diligence processes for individual and entity accounts, and pre-existing and new accounts. There are different due diligence deadlines for each account type:

- Review of high value accounts must be completed by June 30, 2015.
- Review of low value accounts must be completed by June 30, 2016.
- Review of new entity and individual accounts is 90 days within account opening

Investors that do not comply with all the FATCA requirements will be subject to a 30% withholding tax.

The FATCA regime consists of the FATCA final regulations and the IGAs. IGAs are Tax Information Exchange Agreements that the US has signed with partner jurisdictions to implement FATCA. The IGAs are based on bilateral agreements. Every IGA is country specific and unique.

Treasury developed two Model IGAs. The Model IGAs were developed to support the implementation of FATCA on a global scale by removing legal barriers that would otherwise prevent the exchange of information with the IRS. The IGAs provide relief with respect to certain FATCA requirements.

The Model 1 IGA requires the information to be reported to the local tax authorities whereas the information is exchanged with the IRS. The Model 2 IGA requires the information to be directly reported to the IRS.

UK entered into an IGA with the US in 2012. The UK was one of the early adopters of the Model 1 IGAs and has shown tremendous cooperation with respect to implementing FACTA under local law. The UK also developed its own FATCA regime called "UK FATCA". This regime is leveraged off US FATCA.

The Netherlands signed a Model 1 IGA in 2013. The Netherlands published guidance notes in Dutch in January 2015, a week before the reporting deadline was due. To date the Netherlands has not published English guidance notes.

As part of a coordinated effort to improve global tax compliance, the OECD developed the Common Reporting Standard in 2013. Common Reporting Standard is set to be effective in 2017. This standard of information exchange is based on multilateral with the G20 countries and the EU. The Common Reporting Standard was also leveraged off FATCA.

3 DRIVERS OF THE INCONSISTENCIES BETWEEN THE FATCA FINAL REGULATIONS AND IGAS

3.1 INTRODUCTION

The previous chapter discussed the theoretical framework of the FATCA regime. The previous chapter provided the reader with sufficient data to understand the information provided in this chapter.

This chapter will address the drivers of the inconsistencies between the FATCA final regulations and the IGAs. Research will be done into legislative history to analyze how this has affected the development of FATCA and the IGAs. Interviews will be held as part of the research to develop a better understanding of Treasury's approach towards the FATCA regime. This chapter will discuss information provided by former government official Michael Plowgian. Michael Plowgian is one of the drafters of the FATCA final regulations and the IGAs.

This chapter will address the following key question:

What are the drivers of the inconsistencies between the FATCA final regulations and the IGAs?

To properly address the key question, the following information will be discussed in this chapter:

- how legislative history and policy concerns shaped the FATCA final regulations and the IGAs;
- the key elements that ensured the different approach towards the FATCA final regulations and the IGAs;
- the coordinated effort to achieve global tax compliance; and
- the drivers for the existence of two Model IGAs.

This chapter is intended to provide the reader with insight into the drivers of the inconsistent approach towards the FATCA final regulations and the IGAs. The italic font is used to emphasize citations from interviews held with FATCA experts.

3.2 HOW LEGISLATIVE HISTORY AND POLICY CONCERNS SHAPED THE FATCA FINAL REGULATIONS

In March 2010, the US enacted a new withholding and reporting regime named FATCA.⁵⁶ US taxpayers' international investments have been increasing in the past years.⁵⁷ FFIs now provide greater investment opportunities and have become a meaningful part in US taxpayers' investment portfolios. In addition, these FFIs are acting more as intermediaries for investments of US taxpayers. The US Treasury believes that FFIs are in the best position to identify and report US taxpayers' accounts held by such FFIs.⁵⁸

The driver for including FATCA into the Income Tax Regulations was the high number of high profile malfunctions with respect to the prevention of tax evasion by US taxpayers through the existing US information reporting systems.⁵⁹ The FATCA final regulations were introduced to address the IRS concerns with regard to US tax evasion through the use of foreign tax structures and products,⁶⁰ and to prevent abuse of information reporting requirements with respect to US taxpayers that hold investments offshore. The US Treasury believes that the information reporting system will strengthen the integrity of US voluntary tax compliance by creating equal footing for both onshore and offshore US investors.⁶¹

⁵⁶ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

⁵⁷ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

⁵⁸ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

⁵⁹ L. Goncalves & E. Shay, 'FATCA offspring', IFC Economic Report 2014

⁶⁰ L. Goncalves & E. Shay, 'FATCA offspring', IFC Economic Report 2014

⁶¹ Treasury Regulations §§1.1471-1.1474, Preamble, Background, II

The Secretary of the US Treasury board was granted authority to set up the FATCA final regulations and procedures, in an effort to create an integrated and balanced approach to FATCA in a manner consistent with its principal policy objectives.

The US Treasury Department and the IRS recognized that the implementation of FATCA is costly and burdensome for FFIs, and that there may be legal barriers in local jurisdictions to comply with the information reporting requirements.⁶² To address concerns of FFIs and NFFEs, meetings have been carried out with various stakeholders to develop an implementation approach that achieves a balance between satisfying policy objectives and minimizing the burdens put on stakeholders.⁶³ As a result, Treasury and IRS established three avenues that address principal concerns with regards to the burdens, the legal barriers in foreign jurisdictions, and the technicality of the implementation of the FATCA final regulations⁶⁴:

1. Adopt a risk-based approach that addresses policy considerations, eliminates unneeded burdens, and build on existing practices and obligations;
2. Develop an alternative intergovernmental approach to implementing the FATCA final regulations by collaborating with foreign governments in order to remove legal barriers with respect to information exchange in foreign jurisdictions, which allows foreign jurisdictions to align FATCA final regulations with local law reporting practices, and achieves further burden reductions; and
3. Develop an administrative approach to facilitate registration processes and the process of entering into an IRS agreement in order to minimize operational costs related to the collection and reporting of FATCA information.

This research will only address the second avenue regarding the IGAs.

3.3 HOW LEGISLATIVE HISTORY AND POLICY CONCERNS SHAPED THE IGAs

Many jurisdictions have domestic privacy laws and practices in place that prevent a FFI from directly reporting US account holder information to the IRS. This means that these FFIs may potentially be exposed to a 30% punitive withholding tax for not complying with the FATCA final regulations. Such outcomes contradict the principal FATCA objective. This principal policy objective is global tax compliance and the mitigation of offshore tax evasion. The US Treasury Department in co-operation with foreign governments developed two Model IGAs to tackle legal barriers and any potential contradicting issues with respect to the principal policy objectives. These two IGAs have been developed to remove domestic legal impediments to compliance, to fulfill FATCA's principal policy objectives, and to provide relief for burdens on FFIs located in partner jurisdictions.⁶⁵

The Model IGAs are intended to provide simplifications and relief with regard to the implementation of FATCA for FFIs in partner jurisdictions. As aforementioned, US Treasury and IRS believe that IGAs represent an effective and efficient manner to implement the FATCA obligations in partner jurisdictions. The IGAs are negotiated with partner jurisdictions. Each IGA is based on the Model IGAs.

The US government along with foreign governments are increasingly aware of undisclosed accounts held offshore by their resident taxpayers. Therefore, foreign governments initiated a coordinated approach towards the international exchange of information. In this effort, there are currently three reporting and information exchange initiatives: FATCA, Common Reporting Standard, and the EU Savings Directive⁶⁶. Common Reporting Standard is not a new practice, according to the OECD this practice was being used

⁶² Id.

⁶³ Id.

⁶⁴ Id.

⁶⁵ Id.

⁶⁶ The EU Savings Directive initiative will not be discussed in this chapter as it is not relevant to the analysis.

before, but only in the recent years has this initiative become more comprehensive and global in scope. To date, most of the international information exchange agreements have been bilateral. These agreements are focused on entering into tax treaties against double taxation. The Common Reporting Standard is a multilateral effort to address tax evasion and improve global tax compliance. Similar to FATCA, the main focus of the Common Reporting Standard lies in the reporting of information about financial accounts. The driver for the coordinated effort is that without global reach, individuals and organizations can still evade their taxes by routing their investment via other countries.

3.4 KEY ELEMENTS THAT ENSURED THE DIFFERENT APPROACH TOWARDS THE FATCA FINAL REGULATIONS AND THE IGAS

The FATCA final regulations and the IGAs have the same policy objective. Moreover, the IGAs have been introduced to facilitate and support the implementation of FATCA in partner jurisdictions. The IGAs provide relief with regard to certain FATCA requirements. This means that entering into an IGA is beneficial for partner jurisdictions FFIs and NFFEs because they are subject to less FATCA requirements. FFIs and NFFEs that are not covered under a Model 1 IGA must comply with the set of requirements under the FATCA final regulations.⁶⁷ Thus, generally the FATCA final regulations provide more FATCA requirements than the IGAs.

Even though the FATCA final regulations and the IGAs have the same policy objective, they consequently contain inconsistencies with respect to FFI classification, due diligence and reporting. These inconsistencies have led to increased burdens and concerns for FFIs and NFFEs with respect to the implementation of the FATCA obligations.

The IGAs are based on the Model IGAs published by the US Treasury. The two Model IGAs differ with respect to the direct or indirect information exchange requirement to the IRS and the reciprocal or non-reciprocal nature of the IGAs.

One of the key elements that caused the inconsistencies are the government negotiations^{68, 69}. During an IGA negotiation, the partner jurisdiction will opt to base its IGA on one of the Model IGAs. Before an IGA is signed, the partner jurisdiction must agree with the IGA, this process is based on government negotiations which leaves room for partner jurisdictions to shape the IGA to a certain extent, to their convenience. Partner jurisdictions covered under a Model 1 IGA are required to implement FATCA under local law. This means that partner jurisdictions under a Model 1 IGA must interpret matters not discussed in the IGAs in a manner consistent with local law. The aforementioned has led to inconsistencies among IGAs. The Model IGAs were also developed in an attempt to reduce inconsistencies among agreements⁷⁰ and to prevent partner jurisdictions from taking a completely different approach towards the Tax Information Exchange Agreements from other countries, which would ultimately contribute to the inconsistencies.

Ultimately, IRS and Treasury were aiming towards minimizing all burdens and has therefore released two sets of regulations. Despite the existing inconsistencies, the IRS and Treasury's position has been to try to make the agreements as consistent as possible, for example, by linking certain statutory provisions with systems that institutions already have in place.⁷¹

⁶⁷ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

⁶⁸ Annex A. M.H. Plowgian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

⁶⁹ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

⁷⁰ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

⁷¹ Annex A. M.H. Plowgian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

According to Michael Plowgian, one of the most crucial discussions during an IGA negotiation is the determination of the threshold percentage of a controlling person. E.g., what provides for a US “substantial owner” and US “controlling person”.⁷² The FATCA statutory provision provides for a 10% ownership threshold whereas an IGA generally provides for a “controlling person,” based on AML/KYC standards in the partner jurisdiction which often, but not always, is 25%. The aforementioned was one of the key elements in the negotiations.⁷³ The US wanted to obtain the 10% ownership threshold and the partner countries wanted to obtain the higher (25%) threshold percentage. Making the percentage of control higher means that there are potentially fewer US accounts reported. The focus is more on who has more actual control over the entity.

After the IGA has been signed and is treated as in effect, the partner jurisdiction is expected to amend and adapt its domestic law to the extent needed to satisfy and coordinate the requirements under the FATCA final regulations.⁷⁴ In order to do so, they must provide and publish regulations and/or guidance notes to facilitate the implementation of FATCA.

Dealing with different jurisdictions and nations that have their own domestic privacy laws and processes in place, is one of the drivers for the existence of the IGAs.⁷⁵ Jurisdictions have their own domestic laws that govern international exchange of information. Before deciding to adopt one of the Model IGAs, partner jurisdictions must find a way to coordinate their domestic laws and the FATCA final regulations. The Model 2 IGA, provides that the partner jurisdiction must comply with the requirements as set forth under the FATCA final regulations. This means that the partner jurisdiction relies on the FATCA final regulations for guidance.

Another factor that has contributed to the inconsistencies between the FATCA final regulations and the IGAs are the specific industry rule sets of the various jurisdictions^{76,77} Every jurisdiction may have its own approach on industry rules. This ultimately determines their approach on the IGAs. For example, depending on whether the partner jurisdiction is a fund domicile covered by financial centers, it would opt to include or exclude holding companies and treasury centers from the definition of a FFI.⁷⁸

Jurisdictions that are covered by financial centers, such as the Netherlands, Ireland and UK, would opt to exclude holding companies and treasury centers from the FFI definition, as local economic policy.⁷⁹ If a jurisdiction covered by financial centers includes holding companies within the definition of a FFI, it increases burdens for holding companies settled in the Netherlands as they must comply with FATCA obligations. The holding companies may decide to relocate to a jurisdiction where there are FATCA rules that are more favorable to them which would negatively impact the Netherlands economy.

In a many instances, partner jurisdictions not covered by financial centers lack guidance with respect to such funds. And partner jurisdictions that are covered by financial centers provide detailed guidance with respect to such funds. For example, fund domiciles, UK and Ireland, both provide very detailed guidance and rule sets for the financial services industry.

⁷² Id.

⁷³ Id.

⁷⁴ Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁷⁵ Annex A. M.H.Plwogian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁷⁶ Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁷⁷ Annex A. B.,Oldenhof, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁷⁸ Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁷⁹ Annex A. B.,Oldenhof, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

3.5 DRIVERS FOR THE EXISTENCE OF TWO MODEL IGAs

The US Treasury developed the Model 1 IGA first. The Model 1 IGA was originally intended to facilitate the development of the OECD Common Reporting Standard which would also provide for a more consistent treatment.⁸⁰ Certain governments would not agree on principal with the Model 1 IGA, so the Model 2 IGA was developed shortly after. The Model 2 IGA was developed based on two government concerns.⁸¹ The first one was that governments fundamentally opposed the automatic exchange of information and would not agree to a Model 1 IGA.⁸² The second government concern was regarding the practicality of the matter. Certain governments did not want to create the systems to gather information from their FFIs and subsequently report the information to the IRS. So, in order to enable FFIs in jurisdictions that for one of the two concerns would not enter into a Model 1 IGA to still participate with FATCA, the Model 2 IGA was developed. Note that in many countries local laws would have prevented these FFIs from reporting information to the IRS in absent of an IGA.

Jurisdictions that chose to enter into a Model 1B IGA instead of a Model 1A did so because according to the US treaty and Tax Information Exchange Agreement, tax information can only be exchanged to jurisdictions for purposes of administering and enforcing the income tax laws.⁸³ Therefore, if the partner jurisdiction does not impose income tax, the US cannot exchange information with respect to tax payers in partner jurisdictions.

3.6 SUB CONCLUSION

This chapter addresses the drivers of the inconsistencies between the FATCA final regulations and the IGAs. The pivotal points that were discussed in this chapter was how Treasury's approach towards the FATCA regime contributed to the inconsistencies. Treasury took a bilateral approach towards the IGAs. The bilateral approach allowed partner jurisdictions to negotiate the IGAs. The government negotiations provided partner jurisdictions flexibility to shape the IGAs to a certain extent, to their convenience. The aforementioned has led to different versions and interpretations of the IGAs in partner jurisdictions. This is one of the key elements that caused the inconsistencies.

Another factor that has contributed to the inconsistencies between the FATCA final regulations and the IGAs are the specific industry rules in partner jurisdiction. Every jurisdiction has its own approach on the industry rules based on the partner jurisdictions economy. This means that during the negotiations, partner jurisdictions must take local economic policy into account. This has also contributed to the inconsistencies between the FATCA final regulations and the IGAs.

⁸⁰ Annex A. M.H.Plougian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

⁸¹ Id.

⁸² Id.

⁸³ Id.

4 WHICH INCONSISTENCIES EXIST BETWEEN THE FATCA FINAL REGULATIONS, THE NETHERLANDS AND THE UK IGA WITH REGARD TO FFI CLASSIFICATION?

4.1 INTRODUCTION

The previous chapter addressed the drivers of Treasury's inconsistent approach towards the FATCA final regulations and the IGAs. This chapter will discuss the inconsistencies that exist between the FATCA final regulations, the Netherlands and the UK IGA. In order to properly address this key question, a comparative analysis is done to identify each inconsistency. The FFI classification in the FATCA final regulations, the Netherlands and the UK IGA and guidance notes, will be compared with each other. The results of the analysis will be discussed in this chapter.

Each inconsistency will be discussed separately through the course of this chapter. The Netherlands and UK IGA were chosen as part of the research in order to illustrate the importance of guidance provided by partner jurisdictions. The UK has detailed guidance which makes implementation of the FATCA requirements a simpler process. The Netherlands does not provide detailed guidance which contributes to the industry challenges due to lack of guidance.

This chapter will address the following key question:

Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the FFI classification?

This chapter will discuss the following information:

- the classification of holding companies and treasury centers as FFIs;
- the term substantial US owner in the FATCA final regulations versus controlling person in the IGAs; and
- the definition of an investment entity.

This chapter is intended to provide the reader with insight into the inconsistencies between the FATCA final regulations and the IGAs with respect to FFI classification. The FFI classification is the first step in determining the FATCA requirements for a respective entity. This chapter is also intended to illustrate the main difference between the Netherlands and the UK IGA. The main difference is the guidance provided by the Netherlands and the UK. The lack of guidance is one of the main industry challenges. The industry challenges will be discussed in chapter 6.

Before discussing each notable inconsistency, the general rules will be discussed. These rules are based on the FATCA final regulations. Subsequently the interpretation the Netherlands and the UK IGA will be discussed. The italic font is used to emphasize citations of the law.

4.2 THE CLASSIFICATION OF HOLDING COMPANIES AND TREASURY CENTERS AS FFIS

One of the inconsistencies with respect to FFI classification is the classification of holding companies and treasury centers as FFIs. Many IGA jurisdictions did not adopt the fifth category of FFIs. As a general matter, the decision to include holding companies and treasury centers within the definition of a FFI is based on local economic policy.

The FATCA final regulations includes five types of institutions within the definition of a FFI.

The FFI categories according to the FATCA final regulations are as follows:

1. *Depository Institution*⁸⁴
2. *Custodial Institution*⁸⁵
3. *Investment Entity*⁸⁶
4. *Specified Insurance Company*⁸⁷
5. *Holding and Treasury Center*⁸⁸

General rules

Holding companies and treasury centers were swept under the definition of a FFI to prevent situations where FFIs would create holding companies to direct all US investments and investments that give rise to withholdable payments under the holding company.⁸⁹ This would result in the FFI not having withholdable payments whereas no withholding would apply. Generally, many IGA jurisdictions have not adopted the fifth category of FFI because withholding does not apply under the IGAs. So the concern of having holding companies set up to prevent withholding does not apply when it comes to the IGA.

According to the FATCA final regulations the following holding companies and treasury centers fall within the scope of a FFI.

*A company is considered a holding company and classifies as a FFI “if the entity’s primary activity consists of holding (directly or indirectly) all or part of the outstanding stock of one or more members of its “expanded affiliated group” (“EAG”). A partnership or any other non-corporate entity is considered to be treated as a holding company if substantially all the activities of such partnership consist of holding more than 50% of the voting power and value of the stock of one or more common parent corporation(s) of one or more expanded affiliated group(s).”*⁹⁰

*An entity is classified as a Treasury Center if its primary activities consists of entering into investment, hedging, and financing transactions with or for members of its expanded affiliated group for purposes of*⁹¹:

- (i) *Managing the risk of price changes or currency fluctuations with respect to property that is being held or will be held by the EAG*
- (ii) *Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to borrowings made or to be made by the EAG*
- (iii) *Managing the risk of interest rate changes, price changes, or currency fluctuations with respect to assets or liabilities to be reflected in financial statements of the EAG*
- (iv) *Managing the working capital of the EAG such as by cash pooling the balances of affiliates or by investing or trading in financial assets only for the risk of such entity or any members of its EAG*
- (v) *Acting as a financial vehicle for the EAG*

The Netherlands IGA

As mentioned before, not all IGAs have adopted this fifth category of financial institutions. The Netherlands is one such country. In the Netherlands IGA, the Ministry of Finance agreed to constitute depository institutions, custodial institutions, investment entities, and specified insurance company as financial institutions.

⁸⁴ Treasury regulations §1.1471-5(e)(1)(i)

⁸⁵ Treasury regulations §1.1471-5(e)(1)(ii)

⁸⁶ Treasury regulations §1.1471-5(e)(1)(iii)

⁸⁷ Treasury regulations §1.1471-5(e)(1)(iv)

⁸⁸ Treasury regulations §1.1471-5(e)(5)(i)(C), §1.1471-5(e)(5)(i)(D)(1)

⁸⁹ Annex A. M.H.Plougian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

⁹⁰ Treasury regulations §1.1471-5(e)(5)(i)(C)

⁹¹ Treasury regulations §1.1471-5(e)(5)(i)(D)

The definition of a financial institution⁹² under the Netherlands IGA includes any:

- 1. Depository Institution⁹³*
- 2. Custodial Institution⁹⁴*
- 3. Investment Entity⁹⁵*
- 4. Specified Insurance Company⁹⁶*

The Netherlands took a different approach from the FATCA final regulations with respect to the classification of holding companies and treasury centers as a FFIs. The guidance notes (in Dutch) excludes holding companies and treasury centers from the definition of a FFI, unless it forms part of the same group of affiliated companies (Expanded Affiliated Group) to which at least one FI belongs, or is formed and used as an investment vehicle. The Netherlands refers to the FATCA final regulations for guidance with respect to the definition of expanded affiliated group. Thus, the Netherlands does not include all holding companies within the definition of a FFI. It only includes those holding companies and that are held by parent companies that are considered FIs provided that they meet the expanded affiliated group test.

According to the FATCA final regulations an expanded affiliated group means:

“An expanded affiliated group means one or more chains of members connected through ownership by a common parent entity if the common parent entity directly owns stock or other equity interests meeting the requirements of paragraph (i)(4) of this section in at least one of the other members (for purposes of this paragraph (i), the constructive ownership rules of section 318 do not apply). Generally, only a corporation shall be treated as the common parent entity of an expanded affiliated group, unless the taxpayer elects to follow the approach described in paragraph (i)(10).

The term member of an expanded affiliated group means a corporation or any entity other than a corporation (such as a partnership or trust).

A corporation (except the common parent entity) will be considered owned by another member entity or by the common parent entity if more than 50 percent of the total voting power of the stock of such corporation and more than 50 percent of the total value of the stock of such corporation is owned directly by one or more other members of the group (including the common parent entity).”⁹⁷

So, even though the Netherlands does not take the same approach as the FATCA final regulations, it does refer to FATCA final regulations for guidance. The Netherlands also provides the opportunity for FFIs and NFFEs to rely on the FATCA final regulations for the entity classification test. This means that if an entity prefers to conduct entity classification according to the FATCA final regulations, it may do so.

The UK IGA

The UK recently changed its position on the treatment of holding companies and treasury centers. Before March 11, 2015, the United Kingdom constituted holding companies and treasury centers that are part of financial groups, as FFIs. Before March 11, 2015, UK had the same approach towards FFI classification as the FATCA final regulations.

⁹² Article 1, 1(g), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

⁹³ Article 1, 1(i), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

⁹⁴ Article 1, 1(h), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

⁹⁵ Article 1, 1(j), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

⁹⁶ Article 1, 1(k), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

⁹⁷ Treasury regulations §1.1471-5 (e) (1) (v)

HM Revenue & Customs recently released a statement with an update regarding the categories that qualify as financial institutions. The publication stated that the classification of holding companies and treasury centers as financial institutions is incorrect.⁹⁸ This update has implications for relevant holding companies and treasury centers that were previously treated as FFIs.⁹⁹ Holding companies and treasury centers that were previously considered FFIs are now Passive NFFEs and must deregister from the IRS FATCA portal. The new entity classification went into effect April 15, 2015. Since UK's change in position, the Netherlands and the UK have the same four categories of institutions that classify as FFIs.

To date the following categories fall under the scope of a financial institution:

1. *Depository Institution*¹⁰⁰
2. *Custodial Institution*¹⁰¹
3. *Investment Entity*¹⁰²
4. *Specified Insurance Company*¹⁰³

According to the interview held with Michael Plowgian, his understanding of this issue, after having spoken to other governments, was that "originally it was thought that it would benefit FFIs by allowing holding companies of fund groups or a bank holding company to register as FFIs with the IRS and then basically allow them to do a consolidated compliance program at the level of the parent company or things like that and if they weren't included as FFIs then they could not register with the IRS as FFIs." The reason why the UK has recently changed its mind on the classification of holding companies and treasury centers is currently unknown.

4.3 THE INTERPRETATION OF THE TERM SUBSTANTIAL US VERSUS CONTROLLING PERSON

Another notable inconsistency with respect to crucial definitions in the classification process, is the ownership test of a substantial US person in the FATCA final regulations versus controlling person of an entity in the IGAs. The FATCA final regulations require certain NFFEs to report information about their substantial US persons. A substantial US owner is any US taxpayer holding more than 10% ownership interest in an entity.

In an IGA the term substantial US owner is replaced by the term controlling person. This means that the terms provide the same role. Under an IGA certain NFFEs must report accounts held by controlling persons. A controlling person is (in most cases) a US person with more than 25% ownership interest in an entity. This inconsistency will be discussed below.

General rules

The FATCA final regulations provides that "the term, substantial US Owner means:

- *with respect to any foreign corporation, any specified US person that owns, directly or indirectly more than 10 percent of the stock of the corporation (by vote or value)*
- *With respect to any foreign partnership, any specified US person that owns, directly or indirectly more than 10 percent of the profits interests or capital interests in such partnership.*

⁹⁸ The international tax compliance regulations 2015, United Kingdom 24 March 2015, 2015 No.878.

⁹⁹ KPMG United Kingdom, 'Reduced categories of financial institutions and reporting', Weekly Tax Matters 13 March 2015, p.3., www.kpmg.com

¹⁰⁰ Article 1, 1(i), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

¹⁰¹ Article 1, 1(h), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

¹⁰² Article 1, 1(j), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

¹⁰³ Article 1, (k), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

- *In the case of a trust, any specified US person treated as an owner of any portion of the trust, any specified US person that holds, directly or indirectly, more than 10 percent of the beneficial interests of the trust.*¹⁰⁴

A specified US person is “any US person, other than:

1. *a corporation the stock of which is regularly traded on one or more established securities markets;*
2. *any corporation that is a member of the same expanded affiliated group*
3. *US or any wholly owned agency or instrumentality thereof*
4. *Any state of the US, any US territory, any political subdivision of any of the foregoing*
5. *Any organization exempt from taxation*
6. *Any bank as defined in section 518 of the US IRC*
7. *Any real estate investment trust*
8. *Any regulated investment company*
9. *Any common trust fund*
10. *Any trust that is exempt under taxation*
11. *A dealer in securities, commodities, or derivative financial instruments (including notional principal contracts, futures, forwards, and options) that is registered under the laws of the US*
12. *A broker*
13. *Any tax-exempt trust*¹⁰⁵

According to the FATCA final regulations, the threshold to qualify as a substantial US owner is 10%. This means that any specified US person who holds more than 10% interest in the entity, partnership or trust is considered a substantial US owner. Substantial US owners must be reported to the IRS. Under the IGAs the definition of substantial US owner is replaced by the term controlling person.¹⁰⁶

Generally, the IGAs provide that the term controlling person shall be interpreted in a manner consistent with the Financial Action Task Force Recommendations (“FATF”). The FATF provides that may be relied upon AML/KYC procedures to determine whether an entity has any controlling persons. AML/KYC procedures are measures introduced to identify customers/clients in order to prevent money laundering, fraud and financial crime. Know Your Customer (“KYC”) includes the due diligence process that regulated markets are required to perform in order to identify its clients by obtaining certain information and confirming such information prior to starting financial business with said clients. This procedure is required in order to meet the due diligence and regulatory legislation, including anti-money laundering (“AML”) and countering the financing terrorism (“CFT”).

The threshold for beneficial owners under the AML/KYC procedures is 25%. So, for the definition of controlling person one must look at the recommendations of the FATF and rely on definitions pursuant to the AML/KYC procedures, this states that the threshold for beneficial ownership is 25%. The US Treasury decided to sweep in owners with less than 25% interest in an entity, partnership, etc., as a means of expressing the importance of obtaining information of accounts with less than 25% ownership interest.

The Netherlands IGA

Under the Netherlands IGA a controlling person is defined as “the natural persons who exercise control over an entity. In the case of a trust, such term means the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust, and in the case of a legal arrangement other than a trust, such term means persons in

¹⁰⁴ Treasury regulations §1.1473-1(b)

¹⁰⁵ Treasury regulations §1.1473-1(c)

¹⁰⁶ Treasury regulations §1.1471-1(b)(128)

equivalent or similar positions. The term “Controlling Persons” shall be interpreted in a manner consistent with the Financial Action Task Force Recommendations” (“FATF”).¹⁰⁷

For the interpretation of the term controlling persons, FATF refers to the definition as set forth in AML/KYC procedures. According to the AML/KYC procedures the term controlling person means a person with at least 25% ownership interest. This means that Netherlands obtains the 25% ownership threshold for controlling persons whereas the FATCA final regulations obtains a 10% ownership interest for substantial US owners.

The UK IGA

Under the UK IGA a controlling person is defined as “the natural persons who exercise control over an Entity. In the case of a trust, such term means the settlor, the trustees, the protector (if any), the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over the trust, and in the case of a legal arrangement other than a trust, such term means persons in equivalent or similar positions. The term “Controlling Persons” shall be interpreted in a manner consistent with the Financial Action Task Force Recommendations” (“FATF”).¹⁰⁸ For the definition of controlling person one must look at the recommendations of the FATF and rely on definitions pursuant to the AML/KYC procedures, this states that the threshold for beneficial ownership is 25%.

AML/KYC procedures are onboarding documentation processes that entities already have in place. Thus, partner jurisdictions that adopted the 25% threshold with respect to controlling persons, wanted to simplify the due diligence process for FFIs and NFFEs by linking the process with systems that entities already have in place. The inconsistency with regard to the definition of substantial US owner versus controlling person is due to the fact that partner jurisdictions wanted to link the FATCA due diligence requirements with the processes that were already in place which in turn would make the implementation simpler for FFIs.

4.4 THE DEFINITION OF AN INVESTMENT ENTITY

Another notable inconsistency exists in the definition and interpretation of an investment entity. In the FATCA final regulations the term investment entity is specifically described. The description includes among others, what types of entities fall within the scope of an investment entity. The IGAs leave out indispensable information in the wording of the definition of an investment entity. This creates grey areas for FFIs and NFFEs with respect to the interpretation of the definition. The abovementioned inconsistency will be discussed below in greater detail.

General rule

The FATCA final regulations defines an investment entity as:

- (A) “ any entity that **primarily** conducts as a business one or more of the following activities or operations for or on behalf of a customer:*
 - (4) Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
 - (5) Individual and collective portfolio management; or*
 - (6) Otherwise investing, administering, or managing funds or money on behalf of other persons.*
- (B) The entity’s gross income primarily attributable to investing, reinvesting, or trading in financial assets, and the entity is managed by another entity that is a financial institution. An entity is*

¹⁰⁷ Article 1, 1(mm), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

¹⁰⁸ Article 1, 1(mm), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

managed by another entity that is a financial institution if the managing entity performs either directly or through a third party service provider, any of the activities mentioned in (A).

- (C) *The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.*"¹⁰⁹

The FATCA regulations provide three types of Investment entities, described above, Investment entity type A, B and C. The IGAs provide for a somewhat simplified approach to the definition of an investment entity.

The Netherlands IGA

The Netherlands IGA provides the same language and definition of an investment entity as the UK IGA, which is:

An investment entity is considered "any entity that conducts as a business (or is managed by an entity that conducts as a business) one or more of the following activities or operations for or a behalf of a customer:

- (i) *Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
- (ii) *Individual and collective portfolio management; or*
- (iii) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*"¹¹⁰

One keen difference with respect to the IGAs is that the Netherlands has not published its final guidance notes to date and the Dutch guidance to the IGA provides little clarification of an investment entity.

The Dutch guidance includes the definition of what constitutes as primarily conducting as a business, which includes the 50% gross income threshold per under the FATCA final regulations. The Dutch guidance also provides that an entity can opt to use the definitions under the final regulations for the entity classification. The Dutch guidance provides fewer clarification than the UK guidance.

The UK IGA

Initially when the IGA was signed and released, the UK defined entities as investment entities only if they would perform activities described in type A investment entity under the FATCA final regulations.

*Under the UK IGA an investment entity is defined as "any entity that **conducts as a business** (or is **managed by** an entity that conducts as a business) one or more of the following activities or operations for or a behalf of a customer:*

- (i) *Trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
- (ii) *Individual and collective portfolio management; or*

¹⁰⁹ Treasury regulations §1.1471-5(e)(4)

¹¹⁰ Article 1, 1(j), Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

- (iii) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*¹¹¹

Prior to the release of the UK guidance, the definition of an investment entity was generic and ambiguous. For example, the word “primarily” was left out of the definition of an investment entity and replaced with the word “managed by” (see citation). Including the word “managed by” in the definition of an investment entity leaves the impression that the UK tried to incorporate the two investment entity types (A and B) into one harmonious definition.

An entity is an investment entity if it primarily conducts as a business one of the aforementioned activities. The word “primarily” means 50% or more. The UK did not include this word into the definition of an investment entity in the IGA which left a lot of room for interpretation with respect to the threshold of primarily conducting as a business.

This grey area was removed when the UK published its guidance notes. The UK guidance notes included language that defined the UK mirroring the FATCA final regulations’ definition of an investment entity.¹¹² The UK guidance also provided language with respect to what was constituted as primarily conducting as a business. The guidance notes does not include the word “primarily”, however it does describe that an entity is considered to conduct a business if the entity’s gross income equals or exceeds the 50% threshold per the FATCA final regulations.¹¹³ The UK guidance brought much clarity for FFIs and NFFEs with respect to FFI classification.

Another inconsistency with respect to the definition of investment entity is that according to the FATCA final regulations, an investment entity type B is an entity whose gross income is primarily attributable to investing, reinvesting, or trading in financial assets, and the entity is managed by another entity that is a **financial institution**. An entity is managed by another entity that is a financial institution if the managing entity performs either directly or through a third party service provider, any of the activities mentioned in (A).

*Under the UK IGA, an investment entity is considered “any entity that conducts as a business (**or is managed by an entity that conducts as a business**) one or more of the following activities or operations for or a behalf of a customer:*

- (i) *Trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
- (ii) *Individual and collective portfolio management; or*
- (iii) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*¹¹⁴

Under the IGA, one would assume that the managing entity must be an investment entity and that it must perform the activities described in the IGA context.

¹¹¹ Article 1, 1(h), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

¹¹² Section 2.28, Implementation of the international tax compliance (United States of America) regulations 2014. Guidance notes, United Kingdom 28 August 2014.

¹¹³ Id.

¹¹⁴ Article 1, 1(h), Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

4.5 SUB CONCLUSION

This chapter addressed the inconsistencies with regard to FFI classification between the FATCA final regulations, the Netherlands and UK IGA. The inconsistencies that were identified, are based on the comparative analysis of the FATCA, the Netherlands and the UK IGA.

The three notable inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with regard to FFI classification are as follows:

1. The classification of holding companies and treasury centers as FFIs.

The FATCA final regulations considers holding companies and treasury centers as FFIs. This means that these type of companies are also subject to the FATCA due diligence, reporting and withholding obligations. Most IGAs do not include holding companies and treasury centers within the scope of a FFI. Certain partner jurisdictions specifically excludes holding companies and treasury centers within the definition of a FFI. Specific exclusions are noted in the partner jurisdictions guidance notes.

The Netherlands' guidance provides that the Netherlands excludes holding companies and treasury centers from the definition of a FFI, unless it forms part of the same group of affiliated companies to which at least one FI belongs, or is formed and used as an investment vehicle. This means that if a holding company is owned by a parent that is FFI, and that parent owns more than 50% of the voting stock of the holding company, that holding company would classify as a FFI. The Netherlands refers to the FATCA final regulations for guidance with respect to the definition of expanded affiliated group.

The UK recently changed its position on the treatment of holding companies and treasury centers. Before March 11, 2015, the United Kingdom constituted holding companies and treasury centers that are part of financial groups as FFIs per the FATCA final regulations. As of April 15, 2015, holding companies and treasury centers will not be classified as FFIs.

2. The interpretation of the term substantial US owner in the FATCA final regulations versus controlling person in the IGAs.

The FATCA final regulations requires certain NFFEs to report information about their substantial US persons. A substantial US owner is any US taxpayer holding more than 10% ownership interest in an entity. In an IGA the term substantial US owner is replaced by the term controlling person. This means that the terms provide the same role. Under an IGA certain NFFEs must report accounts held by controlling persons. A controlling person is (in most cases) a US person with more than 25% ownership interest in an entity.

Under the Netherlands IGA the term controlling person is interpreted in a manner consistent with FATF recommendations. FATF refers to the definition as set forth in AML/KYC procedures. According to the AML/KYC procedures the term controlling person means a US person with at least 25% ownership interest.

The UK guidance notes provides that the threshold of ownership interest to classify as a controlling person is 25%.

3. The definition of an investment entity.

Another notable inconsistency exists in the definition and interpretation of an investment entity. This inconsistency is the result of the inconsistent language used in the FATCA final regulations and the IGAs to describe the term investment entity.

The FATCA regulations provide three types of Investment entities (A, B and C).

- (A) *“any entity that **primarily** conducts as a business one or more of the following activities or operations for or on behalf of a customer:*

- (1) *Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
- (2) *Individual and collective portfolio management; or*
- (3) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*
- (B) *The entity's gross income primarily attributable to investing, reinvesting, or trading in financial assets, and the entity is managed by another entity that is a financial institution. An entity is managed by another entity that is a financial institution if the managing entity performs either directly or through a third party service provider, any of the activities mentioned in (A).*
- (C) *The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.*"¹¹⁵

The IGAs provide for a somewhat simplified approach to the definition of an investment entity. Initially when the IGA was signed and released, the UK defined entities as investment entities only if they would perform activities described of type A investment entity.

In the Netherlands and UK IGA the word "primarily" is left out of the definition of an investment entity and replaced with the word "managed by". Including "managed by" in the definition of what under the FATCA final regulations definition of investment entity would constitute as type B investment entity, leaves the impression that the UK tried to incorporate type A and type B investment entity into one harmonious definition. However the Dutch and UK guidance provide guidance as to what is the threshold to qualify as "primarily" conducting as a business, in both IGAs the threshold is 50%.

¹¹⁵ Treasury regulations §1.1471-5(e)(4)

5 WHICH INCONSISTENCIES EXIST BETWEEN THE FINAL REGULATIONS, THE NETHERLANDS AND THE UK IGA WITH RESPECT TO DUE DILIGENCE AND REPORTING?

5.1 INTRODUCTION

The previous chapter discussed the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with regard to FFI classification.

This chapter will address the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with respect to due diligence and reporting. In order to address key question 3, a comparative analysis is done to trace each inconsistency. The due diligence and reporting in the FATCA final regulations, the Netherlands and the UK IGA and guidance notes, will be compared with each other. The local country guidance notes will also be used as part of the analysis. The results of the analysis will be discussed in this chapter.

Each inconsistency will be discussed separately through the course of this chapter. The Netherlands and UK IGA were chosen as part of the research in order to illustrate the importance of guidance provided by partner jurisdictions. The UK has detailed guidance which makes implementation of the FATCA requirements a simpler process. The Netherlands does not provide detailed guidance which contributes to the industry challenges due to lack of guidance.

The due diligence procedures will not be discussed in this chapter, for information please refer to chapter 2. Chapter 2 discusses the due diligence procedure according to the FATCA final regulations.

This chapter will address the following key question:

Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to due diligence and reporting?

The following information will be discussed in this chapter:

- the use of publicly available information to determine FATCA status;
- the reporting deadline;
- the method of transmission; and
- the requirement to submit nil returns.

This chapter is intended to provide the reader with insight into the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with regard to due diligence and reporting. Due diligence is a crucial step in determining the reporting requirements for an entity. This chapter is also intended to illustrate the main difference between the Netherlands and the UK IGA. The main difference is the guidance provided by the Netherlands and the UK. The lack of guidance is one of the main industry challenges. The industry challenges will be discussed in chapter 6.

Each notable inconsistency will discuss the general rules according to the FATCA final regulations, the interpretation under the Netherlands and the UK IGA. The due diligence process will be addressed based on the two categories, individual and entity accounts. The first part of the chapter discusses the similar approach of the FATCA final regulations, the Netherlands and the UK IGA with respect to individual accounts, the threshold for high and low value accounts, and the due diligence deadlines. Subsequently, the inconsistencies will be discussed. The italic font is used to illustrate KPMG's approach towards certain FATCA obligations.

5.2 DUE DILIGENCE

Due diligence is the process that must take place in order to review investors and scan for US indicia.

US indicia means any trace or sign of a relation with the US, such as a US citizenship or residency, US place of birth, US address, US telephone number, US mailing address, etc. Upon identifying one of the abovementioned US indicia, the account will be treated as a reportable account, unless the account holder provides certain curative documentation that proves otherwise. Such documentation includes, self-certification, documentary evidence, withholding certificates, etc.

This process also enables FFIs and certain NFFEs to establish the FATCA status of their investors. Depending on which FATCA status an investor has, certain tax documentation must be collected to verify such status. New and pre-existing individual and entity accounts are subject to due diligence.

There are different review procedures and review deadlines for high and low value accounts. A high value individual and entity account are accounts that exceed \$1,000,000. A low value individual account is an account with a value that exceeds \$50,000 but does not exceed \$1,000,000. A low value entity account in an account with a value that exceeds \$250,000 but does not exceed \$1,000,000.

Consistent approach towards due diligence for individual accounts

The FATCA final regulations, the Netherlands and UK IGA generally provide the same due diligence processes for individual accounts. According to the FATCA final regulations, due diligence for low value accounts is done through an electronic search. Due diligence for high value accounts is done through an electronic search and, if necessary, a paper record search. A paper record search is only required in case the electronic search was not able to capture all data needed to identify any of the US indicia types.¹¹⁶

The FATCA final regulations, the Netherlands and the UK IGA have the same threshold for determining high and low value individual and entity accounts. The threshold to classify as a high value individual and entity account is \$1,000,000. To classify as a low value individual account the account must exceed \$50,000 but not exceed \$1,000,000. A low value entity account in an account with a value that exceeds \$250,000 but does not exceed \$1,000,000.

The deadline for identifying and determining FATCA status of pre-existing high value accounts is June 30, 2015. The deadline for determining the pre-existing FATCA status of low value accounts is June 30, 2016. This deadline is consistent with respect to the Netherlands and UK IGA. The review procedure for pre-existing accounts must be completed on or before the aforementioned deadlines. If a FFI or NFFE does not meet these deadlines, that FFI or NFFE will be considered noncompliant. The review procedure for new accounts must be completed within 90 days of account opening.

5.3 INCONSISTENCIES WITH RESPECT TO DUE DILIGENCE

Review procedure for entity accounts

The FATCA final regulations provide for an inconsistent approach towards due diligence for entity accounts.

As mentioned in chapter 2, the due diligence procedure consists of the review of individual and entity accounts. The review procedure for individual accounts does not provide any inconsistencies between the FATCA final regulations, the Netherlands, and the UK IGA. However, the review procedure for entity accounts provides inconsistencies between the FATCA final regulations, the Netherlands, and the UK IGA.

¹¹⁶ The US indicia types are discussed in chapter 2

The Netherlands and the UK IGA, allow FFIs and NFFEs to use publicly available information to determine the FATCA status of entity accounts. The FATCA final regulations does not provide the option to rely on publicly available information to determine the FATCA status of entity accounts.

If the review procedure indicates any US indicia, the entity account will be treated as a reportable account unless it obtains tax documentation to relieve the US claim. Publicly available information may also be used to relieve the claim of US Person. In these cases, the FFI or NFFE may use information that is available to the public, to relieve the claim of US person, instead of requesting the investor for tax documentation to verify its FATCA status. Publicly available information includes any information that is open for the public such as, annual reports, and other similar information that has been published for public eye.

The Netherlands and the UK IGA provide certain relief with respect to due diligence compared to the FATCA final regulations. To determine whether an entity account is held by a Specified US Person, FFIs under an IGA may rely on publicly available information.¹¹⁷ The FATCA final regulations does not provide the option to rely on publicly available information to determine whether an account is held by a Specified US person.¹¹⁸ Generally, in case any type of US indicia is identified, the account concerned must deliver self-certification (W9), documentary evidence, or withholding certificate to establish its FATCA status. The option to rely on publicly available information is considered a burden relief because FFIs may use such information to determine the FATCA status instead of asking the client for a new Form W9 to establish its status.

The example below illustrates the relief provided to FFIs and NFFEs under a Model 1 IGA with respect to due diligence for entity accounts. The IRS has a webpage that lists US tax exempts and foreign tax exempts that have applied to be on the list. KPMG's approach has been to recommend clients to visit the IRS webpage to confirm whether the entity is on the tax exempt list. The IRS tax exempt list is considered publicly available information. FFIs and NFFEs may rely on information from the IRS' webpage to determine an entity's FATCA status. Publicly available information is also any other publicly available information. The FFIs rather visit the webpage than asking the client for a new Form W9 with a FATCA exempt code. Reaching out to clients and investors to request tax documentation is considered a burden. Thus, relying on publicly available information provides relief to FFIs.

5.4 INCONSISTENCIES WITH RESPECT TO REPORTING

5.4.1 Reporting deadline

Another notable inconsistency is the different reporting deadlines in the FATCA final regulations, the Netherlands and the UK IGA. These three regulations have adopted different reporting deadlines.

The local country reporting deadlines and reporting methods are not described in the IGAs. This means that partner jurisdictions under a Model 1 IGA are able to determine these aspects according to local law. Jurisdictions under a Model 2 IGA refer to the FATCA final regulations for guidance. Partner jurisdictions under a Model 1 IGA are given flexibility, to some extent, to determine their own reporting deadlines. In order for FATCA to be practical, Treasury provided partner jurisdictions flexibility to implement FATCA under local law. As a result, partner jurisdictions have taken their own approach towards FATCA. Most partner jurisdictions adopted different reporting deadlines.

¹¹⁷ Annex I, IV,D,1,b, Agreement between the United States of America and the Kingdom of the Netherlands to improve international tax compliance and to implement FATCA, Netherlands 18 December 2013.

¹¹⁸ Treasury regulations §1.1471-4(c)(5)(iv)(B)

The reporting deadline according to the FATCA final regulations is March 31.¹¹⁹ The US provided an automatic 90 day extension for the first filing date. This means that the first reporting deadline has been moved to June 29, 2015¹²⁰, for US withholding agents only. This extension only applies to FFIs covered under a Model 2 IGA. However, non-consenting accounts were due March 31, 2015. For reporting year 2015 and onwards, the normal March 31 deadline applies.

The reporting deadline for Netherlands FIs is January 30, 2015. Note that the Netherlands released the first draft guidance in Dutch on January 22, 2015. This is exactly a week before the reporting was due. After the draft was released, Netherlands stated that the English version would be published soon. To date, the English guidance still has not been published. As a result, many Netherlands FIs were not able to report on the required deadline.

The reporting deadline for UK FIs to report to HMRC with respect to US accounts is May 31, 2015.

The FATCA final regulations, the Netherlands and the UK IGA, adopted different reporting deadlines. Most partner jurisdictions under a Model 1 IGA adopted different reporting deadlines. This increases the burdens for compliance, especially, for international funds. Due to the inconsistency among the reporting deadlines, international funds must now memorize and report on different reporting dates to different tax authorities.

5.4.2 Reporting method

Another notable inconsistency with respect to reporting is the reporting method.

The reporting of FATCA information is done on Form 8966. FFIs and NFFEs do not directly fill in form 8966, they fill in a XML schema which is subject to transmission. The XML schema is a specific excel based file where FFIs and NFFEs insert information. Information will be reported via the XML schema to the IRS whereas the information in the XML schema will be automatically transmitted into Form 8966. The XML schema is the reporting method that is used to transmit the information to the IRS.

As mentioned above, the initial processing of FATCA information is done based on FATCA XML schemas. The IRS has developed different versions of FATCA XML schemas for reporting:

- FATCA XML v1.1.¹²¹
- Sender Metadata XML v1.0¹²²
- Notification XML v1.4.¹²³

Upon receiving the data in the XML schema, the data will be inserted into FATCA Form 8966. The aforementioned process is called FATCA transmission. The method of transmission is not discussed in the IGAs. Therefor under a Model 1 IGA, this matter will be interpreted in a manner consistent with local law. This means that each partner jurisdiction covered by a Model 1 IGA may opt its own method of transmission.

Most partner jurisdictions including the UK, opted to use FATCA XML v1.1., schema provided by the IRS. However, the Netherlands opted to use a specific Netherlands XML format. The Dutch guidance published in January 2015, did not contain detailed language with respect to the method of transmission. Since the Netherlands has not published clear guidance with respect to the method of transmission, Netherlands FIs are still unsure of what method or schema will be used to report information to the local Netherlands tax authorities.

¹¹⁹ Treasury Regulations §1.1471-4(d)(3)(vi)

¹²⁰ Treasury Decision 9657, RIN 1545-BL73

¹²¹ Publication 5124 (Rev. 06-2014), 65544H.

¹²² Publication 5188 (Rev. 4-2015), 67384J.

¹²³ Publication 5189 (Rev. 4-2015), 67385U.

To date, KPMG has reached out to the Netherlands member firm to seek guidance with respect to the reporting requirements. KPMG LLP has not had much luck with respect to guidance on reporting.

The different reporting dates also contribute to the inconsistencies. Ultimately, the more harmonization and consistency there is among the agreements, the more comprehensive and practical the FATCA regime will be.

It is not only the rules that contribute to the inconsistencies but also the way that systems are designed. Certain countries need to collect slightly different data than other countries which is why there are slightly different XML schemas. This creates challenges for FFIs who are trying to do reporting because there are different schemas to be used in different jurisdictions, and for the service providers who are trying to create software's that enables reporting because they must develop different software's for each XML schema.

5.4.3 Nil returns

Another notable inconsistency among the FATCA final regulations and the IGAs is the requirement to submit nil return.

Under a Model 1 IGA, each partner jurisdiction may determine whether they require the submission of nil returns. This flexibility has led to many different interpretations of the reporting requirements. Certain countries require nil returns, and others do not. This requirement has also contributed to one of the inconsistent approaches between the FATCA final regulations, the Netherlands, and the UK IGA.

In some instances FFIs do not have any US investors or clients. In such cases there are no reportable accounts. Reportable accounts are accounts held by US persons. The requirement to submit nil returns entails that FFIs with no reportable accounts must claim that they do not have any US reportable accounts and thus, no US clients or investors. A nil return only includes identifying information of the filers and does not include any account reports.

The FATCA final regulations only require direct reporting NFFEs and sponsoring entities of direct reporting NFFEs to file nil returns. The aforementioned NFFEs are required file nil reports to declare that they have no substantial US owners. Every other entity type is not required to submit nil returns unless this is a requirement under local law. The IRS General Office of Counsel has said that nil returns are not required but that non-filing is one fact that may be examined on audit in determining FATCA compliance.

The requirement to file nil returns is not disclosed in the IGAs. This means that this matter is interpreted under local law. Foreign governments determine whether the filing of nil returns is a requirement. The UK does not require FFIs and NFFEs to submit nil returns. On March 11, 2015 HMRC released a statement with respect to reduced requirements of FATCA reporting. HMRC stated that nil reporting will not be a requirement for the IGA with the US.¹²⁴ The UK amended the nil return requirement in order to better align the requirements under the EU Savings Directive and the OECD Common Reporting Standard. These initiatives do not require the submission of nil returns. This amendment will significantly reduce the number of UK FIs that have to file a report, e.g. trusts and certain Specified Insurance Companies.

In certain jurisdictions the filing of nil returns is a requirement, such as in Ireland, Singapore and Luxembourg. The FATCA guidance notes of these partner jurisdictions contain specific language that address this requirement.

¹²⁴ KPMG United Kingdom, 'Reduced categories of financial institutions and reporting', Weekly Tax Matters 13 March 2015, p.3., www.kpmg.com

The Irish guidance notes state that “reporting financial institutions with no reportable accounts will be required to submit a nil return”.¹²⁵ In most cases the guidance notes specifically address whether nil returns are a requirement. Where a partner jurisdiction does not publish guidance notes that contains language with respect to this requirement, FFIs and NFFEs usually assume that filing nil reports is a requirement. In these cases KPMG recommends a conservative approach to rule out the possibility of the 30% withholding tax. This means that KPMG recommends the filing of nil returns as best practice.

To date, the Netherlands has not released language with respect to the requirement to file nil returns. This has resulted in practical difficulties for Netherlands FIs and for tax advisors to understand the reporting requirements. KPMG LLP has reached out to KPMG Netherlands for guidance on the reporting requirements. Many Netherlands FIs have not been able to properly comply with the reporting requirements due to the lack of guidance.

5.5 SUB CONCLUSION

This chapter addressed the inconsistencies between the FATCA final regulations, the Netherlands and UK IGA with regard to due diligence and reporting. The inconsistencies were identified based on the comparative analysis of the FATCA final regulations, the Netherlands and the UK IGA.

The notable inconsistencies between the FATCA final regulations and the Netherlands and UK IGA with regard to due diligence and reporting are:

1. Review procedure for entity accounts

The FATCA final regulations provide for an inconsistent approach towards the due diligence procedure for entity accounts. The Netherlands and the UK IGA, allow FFIs and NFFEs to use publicly available information to determine the FATCA status of entity accounts. The FATCA final regulations does not provide the option to rely on publicly available information to determine the FATCA status of entity accounts. The option to rely on publicly available information is considered a burden relief for FFIs and NFFEs because FFIs prefer to use publicly available information than reaching out to clients and investors for new tax documentation.

2. The reporting deadline;

According to the FATCA final regulations, the reporting deadline for FFIs and NFFEs, is June 29, 2015 for filing year 2014. For reporting year 2015 and onwards the reporting deadline according to the FATCA final regulations is March 31. The reporting deadline for Netherlands FIs was January 30, 2015. The reporting deadline for UK FIs to report to HMRC with respect to US accounts is May 31, 2015.

3. The method of transmission;

According to the FATCA final regulations, FFIs and NFFEs must use FATCA XML v1.1., schema. The UK also opted to use FATCA XML v1.1., schema. The Netherlands chose a somewhat different approach. The Netherlands opted to use a specific Netherlands XML format as the method of transmission.

4. The requirement to submit nil returns

The FATCA final regulations does not require the filing of nil returns. The FATCA final regulations only require direct reporting NFFEs and sponsoring entities of direct reporting NFFEs to file nil returns. The UK does not require FFIs and NFFEs to submit nil returns. On March 11, 2015 HMRC released a statement with respect to reduced requirements of FATCA reporting. HMRC stated that nil reporting will not be a requirement for the IGA with the US. The Netherlands has not released language with respect to the requirement to file nil returns.

¹²⁵ Section 1, part 2, Guidance notes on the implementation of FATCA in Ireland, Ireland 1 October 2014.

6 INDUSTRY CHALLENGES THAT EMERGED AS A RESULT OF THE INCONSISTENCIES BETWEEN THE FATCA FINAL REGULATIONS AND THE IGAs

6.1 INTRODUCTION

The previous chapter addressed the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with regard to due diligence and reporting. This chapter will address the industry challenges that emerged due to these inconsistencies. This chapter will discuss the industry concerns that FFIs and NFFEs are now facing as a result of the inconsistent approach towards the FATCA final regulations and the IGAs. The Netherlands and UK IGA were chosen as part of the research to illustrate the importance of guidance provided by partner jurisdictions and to illustrate one of the main industry challenges faced to date. One of the main industry challenges faced to date is the lack of guidance in partner jurisdictions. The UK guidance notes provides detailed information which guides FFIs and NFFEs with respect to the implementation of FATCA. This leads to a phased implementation of the FATCA requirements in the UK. However, the Netherlands' guidance notes does not provide detailed guidance and does not guide FFIs and NFFEs in the right direction. Therefore implementation of FATCA in the Netherlands has resulted in delays.

In order to properly address this key question, a field research is done by conducting interviews with FATCA experts and by making observations when working on FATCA engagements. These two elements form the key resources used in this chapter. This chapter discusses many examples of challenges which include, but is not limited to, the Netherlands and UK. Other partner jurisdictions are also used in some examples to illustrate the industry challenges.

This chapter will address the following key question:

What industry challenges are financial institutions and other in scope entities facing as a result of the inconsistencies between the FATCA final regulations and the IGAs?

The following information will be discussed in this chapter:

- education and outreach;
- lack of guidance;
- monitoring; and
- stakeholders concern.

This chapter is intended to provide the reader with insight into the industry challenges and concerns that emerged due to the inconsistent approach towards the FATCA final regulations and the IGAs. The italic font is used to put emphasis on the examples used in this chapter which illustrate the challenges FFIs and NFFEs are now facing.

6.2 EDUCATION AND OUTREACH

One of the main challenges caused by the inconsistencies between the FATCA final regulations and the IGAs, is education and outreach. Getting everyone to understand and comply with the different requirements in different partner jurisdictions is an increased burden for FFIs and NFFEs.^{126 127}

¹²⁶ Annex A. M.H.Plougian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹²⁷ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

The scope of FATCA in itself is tremendously complex because it touches almost every institution in the world, from FFIs to NFFEs. The FATCA requirements differ based on the FATCA status, but in general almost every organization has FATCA requirements to some extent.

The implementation of FATCA on a global scope is based on bilateral agreements. The bilateral agreements allow partner jurisdictions to negotiate and implement FATCA according to local law. This causes for inconsistencies since every country is able to adopt its own approach on FATCA and fine tune the regulations. This fact alone creates different versions of interpretations of the IGAs which must be properly understood in order to comply.

FATCA targets US taxpayers with accounts offshore, but in order to identify US accounts, new due diligence and onboarding processes must be created and implemented in an entity's organization. These processes are supposed to monitor and document almost every individual and entity accounts held by financial institutions to determine US accounts. Entity classification must be performed by every entity to determine its FATCA status. If an entity is a FFI, the institution must register with the IRS, perform due diligence, and report US account information to local tax authority or directly to the IRS. If an entity is classified as a NFFE, the entity must document its status to withholding agents. Apart from the definition of FFI and NFFE, the IGA and FATCA final regulations provide many more definitions that are complicated to understand.

International organizations are growing rapidly. This means that every international organization would have to comply with different regulations and requirements per the different jurisdictions. Thus, the inconsistencies between the FATCA final regulations and the IGAs means that international organizations must comply with different regulations, different interpretations and different sets of requirements based on every partner jurisdiction's IGA. This is due to the fact that IGAs are bilateral agreements. If, by contrast, the agreements would have been based on multilateral agreements such as the CRS, the implementation of FATCA would have been simplified for international organizations because in this case organizations are able to use one strategic approach to implement the documentation and reporting requirements under FATCA.

The original FATCA final regulations consists of more than 200 pages worth of language that describes the entire FATCA process. FATCA consists of compliance requirements for FFIs as well as NFFEs. The extent of the compliance requirements is determined based on the type of institution that the entity concerned is classified as. This means that every entity must perform entity classification on every entity that is part of the organization.

Education and outreach is one of the main FATCA challenges to date. It is incredibly complex for institutions to understand the FATCA regulations and requirements. Implementing these requirements into an organization is another complexity that has raised many questions since FATCA was adopted. In many cases, realizing the requirements on the set deadlines has not proven success. Many partner jurisdictions have extended their local registration or reporting deadlines.

Many organizations request assistance from tax advisors to assist them with the implementation of FATCA. Organizations that have a tax practice in place also request KPMG to review and confirm that the FATCA requirements are done correctly.

KPMG LLP assists with the implementation of FATCA into organizations on many levels. KPMG provides FATCA services that include: creating on boarding processes to simplify the documentation requirements, FATCA manuals which consist of simplified language to comprehend the regulations, FATCA tools and technical and interpretive analysis with respect to entity classification, the IGAs, and local country reporting requirements. During the internship period, the FATCA projects worked on have mostly been engagements with respect to international funds. This only strengthens the statement that the complexity of FATCA for international organizations to comply with the requirements is tremendous and the inconsistencies further increases the burdens placed upon FFIs and NFFEs with respect to the

implementation of FATCA, This is because international funds must comply with different rule sets in different jurisdictions.

6.3 LACK OF GUIDANCE

The lack of guidance is one of the biggest industry challenges to date¹²⁸ because most partner jurisdictions, approximately 75% of jurisdictions, have not published guidance notes yet.¹²⁹ Without these guidance FFIs and NFFEs are not able to comply with the reporting requirements because the Model IGAs do not include language with respect to certain crucial information.¹³⁰ The inconsistencies create grey areas for FFIs and NFFEs which can lead to misinterpretations. The inconsistencies have created grey areas with respect to the interpretation of an investment entity, classification of holding companies and treasury centers as FFIs, the reporting deadlines and, the reporting method of transmission.

As aforementioned, the IGAs are simplified versions of the FATCA final regulations that provide certain relief for the partner jurisdictions' FFIs and NFFEs. One of the disadvantages of having simplified IGAs is that crucial information is left out. This information is left to be filled in with partner jurisdictions' interpretations under local law. Crucial information that is left out in the IGAs include among others, the reporting deadline, and the reporting method. Since these crucial information is not included in the IGAs, FFIs and NFFEs greatly rely on guidance from partner jurisdictions.

In most cases, the IGAs do not provide specific language with respect to holding companies and treasury centers. The Dutch guidance published on January 22, 2015 excludes holding companies and treasury centers out of the definition of a FFI. Such approach provides clarity when it comes to FATCA entity classification. On the other hand, Singapore that has a Model 1B IGA in effect, has issued guidance notes but did not specifically carve out holding companies and treasury centers out of the definition of a FFI.¹³¹

Terms not defined in a Model 1 IGA, may be interpreted in a manner consistent with local law. This means that Model 1 IGA jurisdictions, greatly rely on local guidance to provide the needed information in order to fully comply with the FATCA requirements. Local guidance usually comes out in the form of local regulations or guidance notes. In many cases there is a first draft that must be approved by the ministry of Finance or other parties concerned. Once the first draft is approved, the final draft is published. The issue with the relying on guidance notes is that the US Treasury or local countries have not set a specific deadline for the publishing of these guidance notes. As a result, many partner jurisdictions have not published their guidance notes yet. In many cases this has led to delays in partner jurisdictions with respect to the implementation of FATCA.

The reporting deadline for Netherlands FIs was January 30, 2015. The Netherlands published its first details of guidance (only in Dutch) on January 22, 2015. The guidance did not contain any language with respect to reporting which was in fact a few days away. The guidance also did not contain language with respect to filing extensions nor with respect to applicable penalties for late filing.

FFIs under a Model 1 IGA are required to report to the local tax authority whereas such information would be exchanged with the IRS. The IRS has created a XML schema. The XML schema is an excel file on which must be reported. The information on the XML schema would then be transmitted and translated into Form 8966 (FATCA reporting form). Every Model 1 IGA jurisdiction is provided the flexibility to choose its reporting method. This means that every partner jurisdiction under a Model 1 IGA may opt to use one of the three XML schemas the IRS has provided¹³², or it may opt to use its own local XML

¹²⁸ Annex A. M.H.Plougian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹²⁹ Annex A. D.J.,Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹³⁰ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹³¹ Section 5.1.2, IRAS e-tax guide. Compliance requirements of the Singapore-US Intergovernmental Agreement on Foreign Account Tax Compliance Act, Singapore 17 March 2015

¹³² See chapter 2, reporting

schema. Since the reporting method and reporting deadline is not discussed in the IGAs, partner jurisdictions FFIs and certain NFFEs, rely on guidance in order to meet the FATCA reporting requirements. So, when there is a lack of guidance with respect to the reporting method or the reporting deadline, FFIs and certain NFFEs are not be able to comply with the reporting requirements because they are not provided sufficient information.

The Netherlands opted to use and develop its own local XML schema. However, the Dutch guidance does not discuss the reporting requirements. The Dutch guidance does not provide language with respect to the reporting schema. The Netherlands reporting deadline has already passed and yet there hasn't been any updates, notifications or language regarding the local reporting method. This lack of guidance led to many Netherlands FIs not being able to comply with the reporting requirements on the set deadline.

The aforementioned is an example of lack of guidance by the Netherlands' ministry of Finance. This has resulted in uncertainty for Netherlands FIs regarding their reporting requirements. This lack of guidance has generally resulted in Netherlands FIs not being able to comply with the reporting requirements according to the Netherlands IGA. This has ultimately led to a delayed implementation of FATCA in the Netherlands.

Another potential challenge that arises from the general lack of guidance issue, is that FFIs rely on other partner jurisdictions guidance since they don't have their own guidance to follow. To some extent, FFIs from partner jurisdictions that are relying on other countries guidance, risk misinterpreting their own IGA. This is because ultimately there is no certainty as to the extent that one partner jurisdiction would follow that other partner jurisdictions' guidance.¹³³

Usually, a partner jurisdiction would indicate if it will follow another country's guidance notes. In many cases these indications are coordinated through KPMG member firms. For example, KPMG LLP (US) would reach out to KPMG (Denmark) to ask if there has been any updates with respect to the guidance notes.

Below illustrates an example of Denmark FFIs relying on UK's guidance notes.

The UK IGA and guidance notes section 2.28(a) provides that "investment advisers and investment managers may fall to be a FFI solely because they render investment advice to, or on behalf of a customer for the purposes of investing, managing, or administering funds deposited in the name of the customer. An investment entity established in the UK that is a FFI solely because it manages portfolios for, and acts on behalf of, a customer for the purposes of investing, managing, or administering funds deposited in the name of the customer with a FFI other than a nonparticipating FI. Then that entity will be regarded as a certified deemed compliant FFI."¹³⁴ So if an entity solely provides management and/or advisory services and does not hold financial accounts, said entity will fall under the scope of the exception for providing management/advisory services pursuant to the UK Guidance.

Denmark signed and released a Model 1 IGA on November 19, 2012. To date Denmark has not published any guidance with respect to the implementation of FATCA. So, Denmark FFIs and NFFEs do not have any supporting guidance to rely upon. KPMG LLP has reached out to KPMG Denmark for additional guidance on the treatment of investment managers. In correspondence with KPMG Denmark, KPMG Denmark confirmed that they anticipate that the Denmark guidance will follow UK guidance. The UK guidance provides an exception for investment management/advisory services.¹³⁵ Since Denmark has not published guidance notes yet, KPMG LLP took a conservative approach towards the treatments of

¹³³ Annex A. M.H.Plwogian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹³⁴ Section 2.28(a), Implementation of the international tax compliance (United States of America) regulations 2014. Guidance notes, United Kingdom 28 August 2014.

¹³⁵ Id.

investment managers. KPMG recommends treating that respective entity as a FFI and monitor the status until further guidance is issued on treatment of investment managers and investment advisors.

Before the UK, and the Netherlands guidance notes were published, KPMG was taking a conservative approach with respect to the classification of investment entities as FFIs. So, if an entity was primarily conducting as a business any investment activities¹³⁶, it would automatically fall within the scope of an investment entity. KPMG took a conservative approach because there wasn't any guidance on what the term "primarily" meant, it could have meant different percentages ranging from 1% to 100%.

In the aforementioned cases KPMG recommends taking a conservative approach to rule out the risk of being regarded as noncompliant. When the guidance notes were published, it included language with respect to what the word "primarily" means. The word "primarily" means 50% or more. The guidance notes removed this grey area and provided more certainty for FFIs. Note that, even though the UK and the Netherlands guidance has provided clarity on this matter, many partner jurisdictions have not yet released their guidance notes. This means that certain partner jurisdictions are still dealing with this grey area.

6.4 MONITORING

Another challenge is monitoring and remaining current¹³⁷ with new FATCA publications worldly.¹³⁸

FATCA was enacted in 2010 and went into effect in July 2014. In a four-year time, the final version of the FATCA regulations was released, and two Model IGAs were developed. The Model 1 IGA was created first. Model 1 IGAs require guidance under local law. However, Treasury nor local law provided any deadlines on which the guidance must be published.

To date, one of the key aspects in achieving total compliance under the FATCA final regulations and the IGAs has been to monitor new FATCA publications. So, in order to achieve total compliance FFIs and NFFEs must continuously monitoring legislative updates, including publications and newly published guidance. The aforementioned is also referred to as external monitoring. The FATCA regulations and the IGAs are in continuous development. Even when the final guidance have been published, they are still subject to amendments.

*For example, the UK published its final guidance on August 28, 2014. The guidance, states that further amendments and additions to the UK guidance is required as a result of alterations to the US regulations. "Significant changes to this guidance will be published as standalone updates. This guidance will be reviewed to include these updates along with other necessary changes at 6-monthly intervals. The next review of the guidance will be in February 2015."*¹³⁹

The UK guidance provides that external monitoring of the UK guidance is necessary in order to identify amendments and additions to the UK guidance, and to properly comply with the FATCA requirements.

This example illustrates the importance of external monitoring in order to be FATCA compliant. As aforementioned, the UK published its final version of the guidance notes on August 28, 2014. The final guidance provided language that included holding companies and treasury centers under the definition of a FFI. On March 11, 2015 HMRC published an update to advisors and industry groups with respect to the

¹³⁶ To fall within the scope of an investment entity, the entity must conduct as a business one of the following activities: trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.), foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading, individual and collective portfolio management; or otherwise investing, administering, or managing funds or money on behalf of other persons.

¹³⁷ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹³⁸ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹³⁹ Annex A. Guidance notes Implementation of the International Tax Compliance (United States of America) Regulations 2014, United Kingdom 28 August 2014, p.1.

UK requirements.¹⁴⁰ The UK updates include reduced FATCA reporting and different treatment of holding companies and treasury centers. HMRC will not be requiring nil reporting for FFIs. HMRC also announced that the treatment of holding companies and treasury centers as FFIs is not correct.

This amendment only impacts the amounts of FFIs that must file reports. This change better aligns the requirements under the OECD Common Reporting Standard¹⁴¹ as this initiative does not require nil reporting.

As aforementioned, the UK reduced the categories that classify as FFIs. This change better aligns OECD Common Reporting Standard as this initiative does not consider holding companies and treasury centers as FFIs. In an attempt to create a coordinated effort with respect to international information exchange, this recent amendment would synchronize the existing initiatives. However this amendment has implications for holding companies and treasury centers that have already registered with the IRS as a FFIs, or documented its FATCA status to withholding agents. Holding companies and treasury centers that were previously considered FFIs, are now classified as Passive NFFEs, the self-certifications that have already been supplied to third parties is required to be updated within 30 days of the legislation being amended.¹⁴² Holding companies and treasury centers that have registered with the IRS as FFIs must now de-register from the FATCA registration portal. Amending the legislation at this point, is impractical since entities must now perform the FATCA entity classification test once more to determine their FATCA status. Thus, holding companies that were previously classified as FFIs must perform a new entity classification to determine its FATCA status and it must update tax documentation sent to withholding agents with the new FATCA status. Such unannounced updates of the FATCA regulations in partner jurisdiction further increases the burden and cost for FFIs.

The internal monitoring of any changes in circumstances regarding account holders is also a key aspect in achieving compliance according to FATCA.

FATCA requires the ongoing monitoring of any change in circumstance. If there is any change in circumstance, account holder must provide a valid and recent documentation to confirm its FATCA status.¹⁴³ Changes in circumstance include, e.g. change in place of residence and address, or change of a telephone number.

The abovementioned requirement creates an extra burden for FFIs and NFFEs because not only do institutions and entities have to identify its account holders, but it must also keep track of any changes or developments that may take place starting the time that the account holders are identified. In case of any change in circumstance the FFI or NFFE must obtain a valid documentation.

6.5 US CITIZENSHIP RENUNCIATION

Since FATCA went into effect, many stakeholders have expressed concerns about how the IRS will deal with US taxpayers that in previous years, have not reported their tax information correctly. Stakeholders that in previous years have not reported its financial assets properly are now concerned with the legal persecution and penalties they might be facing.

FATCA is an information-reporting regime, which means that tax is not directly imposed on US persons subject to this regulation. Tax is only withheld in case of noncompliance. The information-reporting regime

¹⁴⁰ KPMG United Kingdom, 'Reduced categories of financial institutions and reporting', Weekly Tax Matters 13 March 2015, p.3., www.kpmg.com

¹⁴¹ The OECD Common Reporting Standard initiative is discussed in chapter 2.

¹⁴² KPMG United Kingdom, 'Reduced categories of financial institutions and reporting', Weekly Tax Matters 13 March 2015, p.3., www.kpmg.com

¹⁴³ Annex I, Agreement between the Government of the United States of America and the United Kingdom of Great Britain and Northern Ireland to improve international tax compliance and to implement FATCA, United Kingdom 12 September 2012.

was enacted to identify US tax payers with assets held offshore, and based on the information obtained, tax everyone subject to taxes in the US.

A big concern for stakeholders that in previous years have not paid the amount of taxes they are subject to pay, is how the IRS will deal with situations of tax debt.¹⁴⁴

So the big concern that tax evaders now face is, when IRS receives their information, and IRS detects that they still owe taxes from previous years, how will the IRS address such situations.¹⁴⁵ Usually situations like these would lead to large penalties and legal persecution.

This large concern has contributed to the high number of US citizenship renunciations. In the first quarter of 2015, the number of US citizenship renunciations has reached a new record.¹⁴⁶ Within the first 90 days of the calendar year 1,335 Americans renounced their citizenship.¹⁴⁷ In 2014, the number of US citizenship renunciations grew compared to 2013. In 2014 there were 3,415 US citizenship renunciations.¹⁴⁸ In 2013 the number of Americans renouncing their US citizenship was 2,999.¹⁴⁹ The high number of renunciations are mainly that of Americans living abroad and complaining about the large burden of the global tax reporting regime – FATCA. In an attempt to reduce the renunciation, the US State Department raised the fee for renunciation in 2013, from \$450 to \$2,350.¹⁵⁰ Despite of the higher cost of renunciation, the number has kept growing since FATCA went into effect. Such effects contradicts FATCA's principal policy objective. Treasury has also had push back from government officials, such as Rand Pau, with respect to the implementation of FATCA. Rand Paul wants FATCA to be repealed. As aforementioned, the high number of US citizenship renunciations due to the implementation of FATCA, contradicts the policy objective. Thus, the high number of US citizenship renunciations negatively impact US' tax revenue.

6.6 SUB CONCLUSION

The inconsistencies between the FATCA final regulations and the IGAs are the result of Treasury's bilateral approach towards FATCA. The industry challenges and concerns that were noted throughout the interviews and observation period will be discussed below.

The industry challenges that have emerged due to Treasury's bilateral approach are as follows:

1. Education and outreach;

One of the main challenges caused by the inconsistencies between the FATCA final regulations and the IGAs, is education and outreach. Getting everyone to understand and comply with the different requirements in different partner jurisdictions is an increased burden for FFIs and NFFEs. The scope of FATCA in itself is tremendously complex because it touches almost every institution in the world, from FFIs to NFFEs. Almost every organization has FATCA requirements to some extent.

Treasury's bilateral approach towards FATCA has resulted in many different versions of interpretations, requirements and regulations between the FATCA final regulations and IGAs which must be properly understood in order to comply.

¹⁴⁴ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁴⁵ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁴⁶ R. Wood, 'New un-American record: renouncing U.S. citizenship', Forbes 8 May 2015, www.forbes.com

¹⁴⁷ Id.

¹⁴⁸ Id.

¹⁴⁹ Id.

¹⁵⁰ Id.

2. Lack of guidance is another industry challenge;

Approximately 75% of jurisdictions, have not published their guidance notes yet. Without guidance FFIs and NFFEs are not able to comply with all their FATCA requirements because an IGA does not provide all the necessary information to guide FFIs and NFFEs. For example, the Model 1 IGA does not provide the reporting deadlines, or the method of transmission. Thus, partner jurisdictions FFIs and certain NFFEs rely on guidance notes to receive information about their reporting requirements.

Another potential challenge that arises from the general lack of guidance is that partner jurisdictions FFIs are following other partner jurisdictions guidance. FFIs in partner jurisdictions are reaching out for guidance since their partner jurisdiction have not yet released its own guidance. This puts the restive FFI at risk for misinterpreting the local IGA.

3. Monitoring;

Another challenge caused by the inconsistent approach towards FATCA, is monitoring and being up to date with new FATCA publications worldly. One of the key aspects in achieving total compliance under the FATCA final regulations and the IGAs, is by continuously monitoring legislative updates, including publications or newly published guidance. FATCA is a moving target and the regulations are in continuous development. Keeping track of all the changes is an increased burden for FFIs and NFFEs.

4. US citizenship renunciation.

Stakeholders have expressed concerns about how the IRS will deal with US taxpayers that in previous years, have not reported tax information correctly. Stakeholders that in previous years have not reported its financial assets properly are now concerned with the legal persecution and penalties they might be facing. Besides the fact that FATCA is a very time consuming and costly regime, the aforementioned stakeholders concern has largely contributed to the high number of US citizenship renunciations. The number of US citizenship renunciations has been growing since FATCA went into effect.

7 SOLUTIONS THAT WILL ADDRESS THE INDUSTRY CHALLENGES THAT EMERGED AS A RESULT OF THE INCONSISTENCIES BETWEEN THE FATCA FINAL REGULATIONS AND THE IGAS

7.1 INTRODUCTION

The previous chapter discussed the industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs. This chapter provides possible solutions to address these industry challenges. In order to properly address this key question, a field research is done by conducting interviews with FATCA experts and by making observations when working on FATCA engagements. These two elements form the key resources used in this chapter.

This chapter will address the following key question:

How can the industry challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?

To properly address the key question, the following information will be discussed in this chapter:

- the FATCA regime's bilateral approach;
- the Common Reporting Standard's multilateral approach;
- the co-operation between US Treasury and stakeholders to address industry concerns;
- the development of a FATCA committee;
- the creation of transitional rules

This chapter is intended to provide the reader with information on possible solutions on how the industry challenges that have emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs can be addressed. The italic font is used to emphasize citations from interviews held with FATCA experts and to illustrate certain examples of industry challenges and practical difficulties.

7.2 BILATERAL VS. MULTILATERAL

The FATCA regime was introduced approximately four years ago. The complexity of the FATCA regime has led to some practical difficulties for FFIs and NFFEs because it touches almost every institution around the world. Every institution has FATCA requirements, to some extent.

After the regime was published, the FATCA final regulations went through multiple changes. To date, FATCA remains a moving target. Partner jurisdictions local laws are also undergoing frequent amendments. The frequent amendments is due to the fact that the implementation of FATCA under local law has been more complex than expected.

The inconsistencies between the FATCA final regulations and the IGAs are the result of the bilateral approach towards the FATCA regime. Even though Treasury drafted two Model IGAs which should prevent local laws from taking a completely different approach towards the implementation of FATCA, Treasury provides foreign governments the flexibility to shape the IGAs to a certain extent. The government negotiations has been the ultimate driver of the inconsistencies between the FATCA final regulations and the IGAs.

One of the main differences between the FATCA regime and the OECD Common Reporting Standard, is that the FATCA regime is based on bilateral agreements and Common Reporting Standard is based on a multilateral agreement. The Common Reporting Standard's multilateral agreement will cover all institutions worldwide. The agreement includes one Common Reporting Standard required process with respect to status identification, due diligence and reporting, that applies to all jurisdictions worldwide.

This approach does not leave room for jurisdictions interpretation of local law. This approach prevents inconsistencies. Thus, if Treasury had taken a multilateral approach towards FATCA, the inconsistencies would be relieved and many of today's practical challenges would not exist.

The bilateral agreements provide that partner jurisdictions under a Model 1 IGA must interpret certain FATCA matters consistent with local laws. This means that partner jurisdictions must publish guidance to address matters not discussed in the IGAs. So, FFIs and NFFEs under a Model 1 IGA rely on local government for guidance in order to comply with FATCA. This means that FFIs and NFFEs are relying on foreign government's political and legal process. These processes are different in every jurisdiction.

Ideally, guidance notes should be published at least six months before the first reporting deadline to give institutions sufficient time to implement the required processes. Note that before guidance has been published, there is little FFIs and NFFEs can do to comply with all the FATCA requirements. As the systems and regulations are now, FFIs and NFFEs that do not comply with the regulations are subject to penalties for noncompliance. Certain governments have taken system delays into account and have provided extensions. One such country is Cayman Islands.

In an interview with Benno Oldenhof, a tax partner from Baker Tilly he states that: ideally, the IGAs would be modeled after one Model IGA and set of one guidance notes, which does not leave room for local laws interpretation, similar to the OESO Model Convention.¹⁵¹ The outcome would be, as CRS' approach, the Model IGA would contain the total scope of the required processes according to FATCA. For example the Model IGA would include one uniform process with respect to entity classification, due diligence, and reporting. These requirements would apply to all jurisdictions. The guidance notes would include elaboration and specifics on the deadlines, reporting method, registration requirement, etc. Such an approach would remove all inconsistencies on a country by country basis.¹⁵²

Although this approach would have been ideal, a multilateral approach towards FATCA is impractical. "FATCA is a very US centric regime"¹⁵³ and to get every jurisdiction on board with FATCA without giving them any say in the matter, would be difficult.¹⁵⁴

The Model 1A IGA provides for a reciprocal approach with respect to information exchange. This means that partner jurisdictions that enter into a Model 1A IGA will also receive information about local tax payers holding money in the US. Thus, foreign jurisdictions will also be able to identify their local tax payers and impose taxes on these tax payers.

The global implementation of FATCA requires the cooperation of foreign jurisdictions because in order to implement FATCA under local law, partner jurisdictions must develop different software programs and systems to report to the IRS and capture all the data needed from FFIs and certain NFFEs. This means that the successful implementation of the FATCA regime greatly relies on foreign governments' cooperation to implement FATCA under local law. Implementing FATCA under local law requires partner jurisdictions to develop all the systems necessary to comply with the FATCA requirements. Creating new processes and systems is very time consuming and costly for foreign governments and for FFIs and NFFEs. So in order to receive cooperation from foreign jurisdictions, US Treasury and IRS, had to provide foreign government's flexibility to shape the IGA, to some extent, to their convenience.¹⁵⁵ If the US hadn't have provided foreign jurisdictions with such flexibility, the FATCA regime would have been impractical because many foreign governments would've not entered into an IGA with the US.¹⁵⁶

¹⁵¹ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵² Id.

¹⁵³ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵⁴ Annex A. D.J. Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵⁵ Annex A. B., Oldenhof, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵⁶ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

Common Reporting Standard was enacted by the OECD. OECD is an international economic organization with the cooperation of more than 30 countries. Common Reporting Standard was leveraged off FATCA to try to combine a synchronized approach with respect to international exchange of information. OECD's multilateral approach towards Common Reporting Standard is feasible because the OECD is such a large economic organization with the collaboration of multiple jurisdictions globally.¹⁵⁷ Thus, OECD has more global outreach than the US which makes a multilateral approach practical.

7.3 COOPERATION BETWEEN US TREASURY AND STAKEHOLDERS

To date the biggest industry challenges caused by the inconsistencies between the FATCA final regulations and the IGAs is, the lack of guidance¹⁵⁸, monitoring of legislative updates¹⁵⁹ and education and outreach¹⁶⁰.

The examples below illustrate practical challenges that have emerged due to the inconsistencies between the FATCA final regulations and the IGAs.

This example illustrates the lack of guidance in the Netherlands. The Netherlands reporting deadline was January 30, 2015. To date, Netherlands has provided little guidance with respect to reporting. This delays the implementation of FATCA in the Netherlands. Due to the lack of guidance in the Netherlands, many Netherlands FIs have not been able to comply with the reporting requirements on the set deadlines.

This example illustrates the burdens for FFIs and NFFEs with respect to monitoring. The UK recently changed its position with respect to FFI classification. Before March 11, 2015, the UK considered holding companies and treasury centers as FFIs. On March 11, 2015, the UK stated that the UK has reversed its position on classifying holding companies and treasury centers as FFIs. Holding companies and treasury centers are now likely classified as NFFEs. This legislative update required the holding companies and treasury centers that have already registered as FFIs with the IRS, to de-register with the IRS and perform a new entity classification test. Thus, continuously changing the FATCA regulations further increases burdens for FFIs and NFFEs. Because even though an FFI has followed protocol, a new legislative update might require the FFI to change its position (registration, entity classification, reporting) on FATCA.

This example illustrates the education and outreach challenge. Another complexity for FFIs and NFFEs is to keep track and comply with the different regulations in different jurisdictions. As these regulations are there are different interpretations and versions of the IGAs, keeping track of all the different regulations is an increased burden for FFIs and NFFEs. With the limited guidance FFIs and NFFEs have been getting, the education has been a big concern. Many entities and institutions reach out to advisors in the tax industry to assist with the legal matters.

In an interview with Michael Plowgian, one of the drafters of the FATCA final regulations and the IGAs, he states that, "the US Treasury and IRS have done as much as they can to try to reduce burden given both the words and the intent of the statute, the regulations have done a lot to try and reduce burden although there are a lot of complaints on how complex the regulations are. But in large that's driven by efforts to reduce the impact of the statute or the impact that the statute would otherwise have on financial institutions." "To some extent there's nothing the US can do about the biggest challenges. The biggest

¹⁵⁷ Annex A. D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵⁸ Annex A. M.H.Plwogian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁵⁹ Annex A. D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁶⁰ Annex A. M.H.Plwogian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

challenges is the lack of guidance under local law and education and outreach, and changing the US regulations wouldn't do anything to any of those challenges.”¹⁶¹

After Treasury published the proposed FATCA final regulations, there have been many complaints from stakeholders with respect to the complexity of FATCA. In an attempt to try to reduce burdens for FFIs and NFFEs, Treasury had a common period where stakeholders can express their concerns to the IRS. These concerns were taken into account. The FATCA final regulations were published in an attempt to try to reduce burdens for FFIs and NFFEs based on the commentary that stakeholders provided. After developing the Model 1 IGA, the US Treasury and IRS, even tried to harmonize the Model 1 IGA as much as possible with the FATCA final regulations to remove inconsistencies.

Although many inconsistencies were removed when the FATCA final regulations were published, there are still inconsistencies between the FATCA final regulations and the IGAs. Even though the inconsistencies further increases burdens for FFIs and NFFEs, repealing the FATCA regime is not possible as this is a statute. So, the big FATCA concern is getting partner jurisdictions to publish their own implementing guidance. According to Michael Plowgian, these inconsistencies are largely driven by government negotiations and Treasury's bilateral approach towards the IGAs.¹⁶² Moreover, the US is not in the position to influence or push partner jurisdictions to publish guidance notes as this is a matter of local law. Thus, the US doesn't have much influence on improving the lack of guidance issue.

7.3.1 Education and outreach

Given that FATCA is a new and very complex set of regulations, the education and outreach challenge is inevitable.¹⁶³ The inconsistencies between the FATCA final regulations and the IGAs in conjunction with various versions and interpretations of the IGAs, further increases burdens for FFIs and NFFEs. This is because international funds must comply with different rule sets in different jurisdictions.

According to Michael Plowgian, he expects that as FATCA goes along and FFIs and NFFEs become more familiar with the regulations and start understanding the requirements, compliance will become a simpler process. Michael Plowgian states that “as FATCA goes along we can't prevent people from getting smarter. So, I think that you may see changes or improvements to the guidance in the future as new issues come up and as the various bugs in the system gets worked out.”¹⁶⁴ Education and outreach is a current challenge that will be resolved as FATCA develops and as FFIs and NFFEs become more familiar with the regulations.

7.3.2 Monitoring

The FATCA final regulations have been drafted twice, the first set of regulations is known as “the proposed regulations” and the second set is known as “the final regulations”. In the second set of regulations Treasury and IRS has done a lot to try to reduce burden that was otherwise caused in the proposed regulations.¹⁶⁵ The proposed regulations and the final regulations show many of differences. In the second set of final regulations, US Treasury harmonized some of the final regulations with what was in the IGAs and simplified certain regulations by taking industry comments in consideration.¹⁶⁶

There have been complaints on how complex the regulations are but the complexity is largely driven by attempts to minimize “the impact of the statute or the impact that the statute would otherwise have on

¹⁶¹ Id.

¹⁶² Annex A. M.H.Plwogian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁶³ Annex A. B.,Labonte, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁶⁴ Annex A. M.H.Plwogian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁶⁵ Id.

¹⁶⁶ Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

financial institutions.”¹⁶⁷ “So there is a sort of tradeoff between simplicity of the regulatory and statutory language and burden on financial institutions.”¹⁶⁸

The IGAs were created by US Treasury to support the global implementation of FATCA. The Model 1 IGA was created first and then the Model 2 IGA was developed after certain jurisdictions wouldn’t agree to sign the Model 1. FFIs in jurisdictions under a Model 1 IGA, rely on guidance from local law for the implementation of the FATCA requirements. Many countries have not yet published their guidance notes. Even when the guidance notes are published they undergo many changes and updates. In order to properly comply with the FATCA requirements, FFIs and NFFEs must continuously monitor for legislative updates.

*This example illustrates the importance of monitoring for legislative updates in order to comply with the FATCA requirements. On February 23, The Cayman Islands tax authority published an update with respect to the change in registration deadline on the Cayman Automatic Exchange of Information Portal. The registration deadline was moved from 31 March 2015 to 30 April 2015.*¹⁶⁹

On 27 April 2015, the Cayman Islands Tax Information Authority released an update which included that the Cayman Islands Tax Information Authority “will not impose penalties on notifications received after April 30, 2015 up to and including May 12, 2015.”¹⁷⁰ This means that the registration deadline was moved again from April 30, 2015 to May 12, 2015.

After the announcement on April 27, 2015, the Cayman Islands Tax Information Authority released a statement on May 11, 2015 extending the registration deadline for Cayman FIs to May 21, 2015 and the deadline for reporting to June 12, 2015 (which was previously May 31, 2015).¹⁷¹ So, the registration deadline was moved from May 12, 2015 to May 21, 2015, and the reporting deadline was moved from May 31, 2015 to June 12, 2015. The delay in the registration and the reporting deadline is partly because the Automatic Exchange of Information Portal (portal by means the local reporting and registration is done), is facing technical challenges.

Cayman Islands changed the registration deadline 3 times. In order for FFIs to be aware of such amendments, they must continuously monitor tax authorities’ website for any legislative updates. Changes or improvements to the guidance in partner jurisdictions are expected to keep occurring as FATCA continuous to develop and as new issues come up.¹⁷²

7.3.3 Lack of guidance

One of the greatest industry challenges to date is the lack of guidance. Many countries that have entered into IGAs with the US have not yet published guidance notes yet. This means that FFIs and NFFEs are not receiving sufficient guidance in order to comply with all their FATCA requirements.

According to Michael Plowgian, to some extent there is nothing the US can do to address the biggest industry challenges, which is among others, the lack of guidance under local law.¹⁷³ It is now up to partner jurisdictions to implement guidance notes and align FATCA with the local regulations with respect to

¹⁶⁷ Annex A. M.H.Plowgian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁶⁸ Id.

¹⁶⁹ KPMG Cayman Islands, ‘Cayman Islands FATCA update including change in notification deadline’, FATCA Alert 24 February 2015, www.kpmg.com.

¹⁷⁰ KPMG Cayman Islands, ‘Cayman Islands FATCA update – announcement by Cayman TIA of no compliance penalties for notifications submitted on or before May 12, 2015’, FATCA Alert April 27 2015, www.kpmg.com

¹⁷¹ KPMG Cayman Islands, ‘Cayman Islands FATCA update – announcement by Cayman TIA of no compliance penalties for notifications submitted on or before May 21, 2015’, FATCA Alert 12 May 2015, www.kpmg.com

¹⁷² Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁷³ Annex A. M.H.Plowgian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

international information exchange. The US is not in the position to influence or push partner jurisdictions to publish guidance notes as this is a matter of local law. Thus, the US does not have much influence on improving the lack of guidance issue.

7.4 IMPLEMENTING DEADLINES FOR GUIDANCE UNDER LOCAL LAW

Currently the US nor partner jurisdictions have enforced a deadline on when the local guidance notes must be published.¹⁷⁴ In order for guidance notes to be effective, they must first go to the legislator and get approved. Relying on partner jurisdictions guidance notes means relying on foreign governments' legislative process. This process is different in every jurisdiction.

To solve the lack of guidance issue, partner jurisdictions may need to implement a deadline on when guidance should be provided to FFIs and NFFEs. This would form part of a synchronized effort to push countries to publish guidance notes in partner jurisdictions. Since there isn't a deadline for countries to publish guidance notes, introducing a deadline and including such in an IGA might be a solution for this issue. Based on the most favored nation clause included in every IGA, the new regulation would automatically apply to all IGAs.

In an interview with Brad Labonte, he states that: "Even though there isn't a deadline to publish guidance notes, there is a deadline for when the information must be exchanged with the IRS, the first deadline is September 30, 2015, which is ultimately similar. The guidance notes are being published in the best interest of the partner jurisdictions' FFIs and not having guidance means that the partner jurisdiction is not implementing FATCA properly and that partner jurisdiction FFIs do not have sufficient information and guidance to comply with the obligations."¹⁷⁵

In order for a guidance deadline to be included in an IGA, the partner jurisdiction must agree to comply with this new regulation during the IGA negotiations. This mechanism might be one that could remove the lack of guidance issue. However, every new regulation is costly. Currently the US is dealing with budgetary constraint which means that it is uncertain whether the US would be willing to invest in another FATCA regulation.

Also, the potential risk to be faced if indeed the guidance deadline is introduced, is that of pushing foreign governments and the whole governmental process, to prioritize FATCA.¹⁷⁶ Sovereign nations don't like being told what to do by another country. Thus, to a certain extent it is unsure as implementing guidance deadline is practical.

This example illustrates certain partner jurisdictions' priority to implementing guidance.

Countries that are covered by financial centers, like the UK and Cayman Islands, have shown to make implementing guidance more of a priority than smaller countries not covered by financial centers.¹⁷⁷ This is because FATCA impacts so many of their industry. And not actively acting on implementing FATCA under local law could possibly affect the countries economically.¹⁷⁸ What possibly can end up happening in countries with no guidance is that funds and FFIs will opt to move their economy to a jurisdiction where there is guidance or where the guidance is more favorable to such funds.¹⁷⁹

As guidance notes often require the approval of the legislator in local countries to be finally effective it might be difficult, especially in smaller countries, to set a specific deadline for when the legislator must

¹⁷⁴ Id.

¹⁷⁵ Annex A. B., Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁷⁶ Annex A. D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁷⁷ Id.

¹⁷⁸ Id.

¹⁷⁹ Annex A. D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

approve the guidance.¹⁸⁰ The risk will then be, despite of the guidance deadline in the IGA, that countries might not be able to meet this deadline because of government practical matters.

7.5 FATCA COMMITTEE

US Treasury and the IRS solicited industry comments to shape the FATCA final regulations. In the past, US Treasury and the IRS had common periods, after having issued either the rules or the regulations, where the public could provide information whether in written briefs¹⁸¹ or hearings, to the IRS. In an interview with Michael Plowgian, he stated that the most effective interaction was when they were provided with concrete factual scenarios.¹⁸² It was those industry comments that were “the most effective to bringing changes to the guidance”.¹⁸³

In an interview Michael Plowgian, he stated: “The interesting thing is that as a government official, I learned a lot of what is effective and what is not-effective sort of with interaction with the government. In the beginning a lot of people came in to the IRS and Treasury and said please make FATCA go away. But that was not possible because it was a statute and there was nothing the Treasury and IRS could do to make it go away and so that was clearly not-effective. Whereas some people recognized that it was not going to go away and provided very concrete factual scenarios and really helped Treasury and the IRS understand the practical difficulties and what it would actually mean to do X, Y, Z, especially for bank personnel or insurance companies personnel and those types of interactions were the most helpful and the most effective to bringing changes to the guidance. And in fact in many cases it was not even tax lawyers who were the most effective but it was most often operation people who were able to explain this is the impact of this or that rule on operation.”¹⁸⁴

So the solution that will address the industry challenges now and in the future must include effective public- government interaction which means people from operations giving concrete factual scenarios to US Treasury and IRS.

A possible solution to address the industry challenges faced to date, is the development of an ongoing FATCA committee. Currently the US does not have such a committee in place that provides continuous discussion on the FATCA challenges. To date the public-government interaction has happened through dialogues and hearings.

The FATCA committee will not directly remove all the issues and challenges caused by FATCA, however it will provide for an ongoing dialogue between US Treasury and IRS, members of foreign governments, stakeholders to communicate their concerns with the legislators. An ongoing dialogue is as important as the regulation itself because this method enables the legislators to hear out industry challenges and make improvements to the regulations to the extent necessary and shape FATCA into a regulation that is practical. Without such committee this will not be possible. In order for a regulation to continuously improve, it is important to receive feedback from stakeholders.

The FATCA committee will provide an indirect solution for the education and outreach challenge, and it will enable stakeholders, legislators, and foreign governments, to meet periodically and discuss the practical challenges/issues that currently exist.

In an interview with Deirdre Joyce, KPMG FATCA expert, she states that: “I think it would be good for them to have an ongoing dialogue because otherwise how else are they going to resolve these issues. I

¹⁸⁰ Id.

¹⁸¹ Annex A. B.,Labonte, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸² Annex A. M.H.Plwgian, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸³ Id.

¹⁸⁴ Id.

am not aware of them having a mechanism in place to have an ongoing dialogue other than people writing, whoever it is, the assistant deputy or commissioner in charge of FATCA, saying this is a problem and hoping that there are enough letters on the same issue that they would address it.”¹⁸⁵

Benno Oldenhof, tax partner at Baker Tilly, states: “I agree with a FATCA committee. That is something that should eventually happen. Obviously, it is ideal to have a committee in place where all the stakeholders are represented. The members of the committee includes members of Treasury, IRS, and FFIs, including US citizens. Such a committee enables collaboration and will further develop the legislation.”¹⁸⁶

Brad Labonte, FATCA expert, states in an interview regarding a FATCA committee that: “I think ideally it would be helpful but they’re dealing with so many issues that it will likely be dealt with just like other regulations are dealt with. But to that extent something like that could arise from a reaction from more multilateral efforts to solve these problems and where the US realizes that they need to pour more resources into insuring that our interest are protected in whatever the outcome is of that process. So I think a lot of that is dictated by how transparency initiatives develop on a global level. If it’s something that the US needs to do to be more cooperative then more resources might be poured into it.”¹⁸⁷

The FATCA committee requires the cooperation of foreign partner jurisdictions and stakeholders to gather periodically and discuss their concerns. The FATCA committee will also provide the legislators with the opportunity to communicate deadlines and explain FATCA requirements. This would address the education and outreach challenge.

Setting up a FATCA committee sounds like the most feasible and effective option to consider to address industry challenges and to allow foreign partner jurisdictions, stakeholders and people from operation to actively participate and get more involved with the regulations. As mentioned before such committee would allow foreign partner jurisdictions to get more involved in the development of the regulations. This could influence the development of partner jurisdictions local laws with respect to the implementation of FATCA because during such dialogues the US can also address its concerns. Such a committee would enable foreign governments to have more influence in the development of the FATCA regime.

Even though a FATCA committee is a mechanism that will indirectly address the industry challenges caused by the inconsistencies between the FATCA final regulations and the IGAs, there are certain points of rebuttal. The US is currently dealing with a budgetary constraint. This means that it is uncertain whether the US government would consider such committee a priority and include such in the US budget. The FATCA committee requires the collaboration of US Treasury, IRS, foreign governments, and stakeholders.

7.6 TRANSITIONAL RULES

Since FATCA has gone into effect, stakeholders expressed concerns about how the IRS will address US taxpayers that have not complied with the US taxation system in previous years. This includes US persons with tax liability in the US or tax evaders that haven’t properly reported their financial assets in previous years.¹⁸⁸ These stakeholders are now concerned about the large penalties and legal persecution that they might be facing once the IRS detects that they haven’t reported their financial assets properly.¹⁸⁹

¹⁸⁵ Annex A. D.J.Joyce, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸⁶ Annex A. B.,Oldenhof, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸⁷ Annex A. B.,Labonte, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸⁸ Annex A. B., Oldenhof, “Drivers between the inconsistencies under the FATCA final regulations and the IGAs”(interview), 2015

¹⁸⁹ Id.

FATCA requires FFIs and NFFEs to implement operational systems into their business to conduct due diligence to trace US persons. The anxiety of receiving the punitive 30% withholding tax is incentive for some people to comply with FATCA. FATCA enables IRS to identify US taxpayers with accounts offshore and identify US taxpayers who haven't properly complied with the US taxation system.

In an attempt to give tax evaders more incentive to report their assets without the concern of being legally persecuted in the future for not having complied with the US taxation system, the IRS should provide some sort of relief for US taxpayers that are FATCA compliant. Such relief should be provided as part of the transitional rules of FATCA. US taxpayers that are FATCA compliant and are acting in good faith towards complying with the FATCA requirements, should be provided relief for years before 2014 with respect to their US tax liabilities. As the first reporting period according to FATCA is 2014, it is fair to provide such a relief as an incentive to get all stakeholders onboard. Ultimately this approach could positively impact the tax revenue as a result of FATCA, as this will make US persons and tax evaders less likely to try to relocate their financial assets to jurisdictions that have privacy laws that doesn't allow the international exchange of information. Such a relief would also reduce the amount of US citizenship renunciations. Since FATCA has gone into effect, the number of US citizenship renunciations has rapidly increased. These transitional rules would address stakeholders concern and reduce US citizenship renunciations.

The transitional rules could be implemented in the FATCA final regulations and the IGAs. These terms are beneficial for stakeholders and FFIs and it does not require effort from the partner jurisdictions. So, the regulation would most likely fall within the most favored nation clause. The most favored nation clause provides that if during an IGA negotiation, more favorable terms have been reached, these favorable terms would automatically apply to all partner jurisdictions.

These transitional rules will address stakeholders and tax evaders concern with respect to the potential legal persecution they might be facing. These rules can also be a mechanism to attract more US tax payers to report on their financial assets which would contribute to the tax revenue.

However, implementing a new regulation can be very costly. Especially now that the US has a budgetary constraint, the US might not have the means to develop a new regulation. In addition, there is currently congressional deadlock and a pushback from Rand Paul as he wants FATCA to be repealed.¹⁹⁰ So in terms of development in regulations, implementing new regulations at this time especially right before the first reporting deadline does not seem very likely. However after the first reporting deadline, there might be some developments.¹⁹¹ Treasury has said that the final regulations might be subject to changes and as FATCA goes into effect and the challenges are identified, there might be development in the regulations.¹⁹²

7.7 SUB CONCLUSION

This chapter summarized the industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs, and proposed methods to address these challenges. This chapter discussed Treasury's bilateral approach towards FATCA and OECD's multilateral approach towards Common Reporting Standard.

Treasury's bilateral approach towards FATCA has led to many inconsistencies among IGAs, and between the FATCA final regulations and the IGAs. Even though a multilateral approach towards FATCA would have prevented inconsistencies, such an approach is impractical. In order to get partner jurisdictions on board with FATCA, Treasury had to provide partner jurisdictions with some flexibility to interpret certain

¹⁹⁰ Annex A. B.,Labonte, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁹¹ Annex A. D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁹² Annex A. M.H.Plougian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

manners under local law. According to Michael Plowgian, Treasury has done everything in its power to try to reduce burdens for FFIs and NFFEs and there is nothing the US can do about the biggest challenges. Currently the biggest FATCA concerns are getting partner jurisdictions to publish their own implementing guidance and help financial institutions do the education and outreach necessary for account holders. Treasury is not in the position to influence local laws to implement guidance as this matter depends on foreign government legislative processes. Pushing foreign governments with implementing deadlines for guidance notes, is not practical, since this process depends on foreign governments legislative processes. Another factor is that foreign governments usually like to have say in legislative processes.

1. FATCA committee

The lack of guidance and education and outreach challenge can be addressed by developing an ongoing FATCA committee. The FATCA committee will provide an indirect solution for the industry challenges faced. The committee will enable stakeholders, US legislators, and foreign governments, to meet periodically and discuss the practical challenges that currently exist. Currently, Treasury does not have such a mechanism in place that provides for ongoing dialogue between US legislators, foreign jurisdictions and stakeholders.

2. Transitional rules

Since FATCA went into effect, many stakeholders have expressed concerns about how the IRS will deal with US taxpayers that in previous years have not reported tax information correctly. Stakeholders that in previous years have not reported their financial assets properly are now concerned with the legal persecution and penalties they might be facing. This has led to many US citizenship renunciations. The high number of renunciations are mainly that of Americans living abroad and not wanting to comply with FATCA.

US citizenship renunciations can be addressed by developing transitional rules that provide relief for US taxpayers that are FATCA compliant and acting in good faith towards complying with the FATCA requirements. The relief should apply to years prior to 2014, and it should relieve all US tax liabilities prior to 2014. Such relief should be provided as part of the transitional rules of FATCA. These transitional rules would work as an incentive to get all stakeholders onboard and tackle the increasing number of US citizenship renunciations. Ultimately this approach would positively impact the tax revenue, as this will make US persons and tax evaders less likely to try to relocate their financial assets to jurisdictions that have privacy laws that doesn't allow the international exchange of information or renounce their US citizenship.

8 CONCLUSION

8.1 INTRODUCTION

This research report discussed the scope of the inconsistencies between the FATCA final regulations and the IGAs. The conclusion will address the key questions and the central question that were discussed in the introduction.

As part of the comparative analysis discussed in chapter 4 and 5, the FATCA final regulations, the Netherlands and the UK IGA was compared to each other to identify the inconsistencies. The Netherlands and the UK IGA were chosen as part of the research to illustrate the importance of guidance provided by partner jurisdictions and to illustrate the industry challenges that emerged due to the lack of guidance. The UK provides detailed guidance which makes implementation of the FATCA requirements a simpler process. The Netherlands does not provide detailed guidance which contributes to the industry challenges due to lack of guidance.

Throughout this research the following aspects were analyzed:

- the drivers of the inconsistencies between the FATCA final regulations and the IGAs;
- the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with respect to FFI classification;
- the inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA with respect to due diligence and reporting;
- the industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs;
- possible solutions to address the industry challenges caused by these inconsistencies.

The central question in this research is:

How can the industry challenges caused by the inconsistencies between the FATCA final regulations and the IGAs be mitigated, with respect to financial institutions and other in scope entities that are active in jurisdictions with IGAs in effect?

In order to properly address the aforementioned central question, the following key questions have been developed:

- (4) What are the drivers of the inconsistencies between the FATCA final regulations and IGAs?
- (5) Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the FFI classification?
- (6) Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the due diligence and reporting?
- (7) What industry challenges are financial institutions and other in scope entities facing as a result of the inconsistencies between the FATCA final regulations and the IGAs?
- (8) How can the industry challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?

8.2 ADDRESSING THE KEY QUESTIONS

This chapter will address each key question accordingly.

8.2.1. What are the drivers of the inconsistencies between the FATCA final regulations and IGAs?

The inconsistencies between the FATCA final regulations and the IGAs are the result of Treasury's bilateral approach towards the FATCA regime. Treasury's approach has been to provide partner jurisdictions with flexibility to some extent, to shape the IGAs. This has led to many different versions and interpretations of the IGAs.

The key element that caused the inconsistencies between the FATCA final regulations and the IGAs, are the government negotiations.¹⁹³ During an IGA negotiation the partner jurisdiction will opt to base its IGA on one of the Model IGAs. The government negotiations provides foreign governments the flexibility to shape the IGAs to a certain extent, to their convenience.

Another factor that has contributed to the inconsistencies between the FATCA final regulations and the IGAs are the specific rules sets of the various jurisdictions¹⁹⁴. Every jurisdiction may have its own approach on industry rules. During a negotiation decisions are made based on local economic policy. Thus, a foreign jurisdictions economic state also determines a foreign government's approach towards the IGAs.

8.2.2 Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the FFI classification?

The three notable inconsistencies between the FATCA final regulations, the Netherlands and the UK IGA are:

1. The classification of holding companies and treasury centers as FFIs.

The FATCA final regulations considers holding companies and treasury centers as FFIs. This means that these type of companies are also subject to the FATCA due diligence, reporting and withholding obligations. Most IGAs do not include holding companies and treasury centers within the scope of a FFI. Certain partner jurisdictions specifically excludes holding companies and treasury centers within the definition of a FFI. Specific exclusions are noted in the partner jurisdictions guidance notes.

The Netherlands guidance provides that, the Netherlands excludes holding companies and treasury centers from the definition of a FFI, unless it forms part of the same group of affiliated companies to which at least one FI belongs, or is formed and used as an investment vehicle. This means that if a holding company is owned by a parent that is FI, and that parent owns more than 50% of the voting stock of the holding company, that holding company would classify as a FFI. The Netherlands refers to the FATCA final regulations for guidance with respect to the definition of expanded affiliated group.

The UK recently changed its position on the treatment of holding companies and treasury centers. Before March 11, 2015, the United Kingdom constituted holding companies and treasury centers that are part of financial groups as FFIs per the FATCA final regulations. As of April 15, 2015, holding companies and treasury centers will not be classified as FFIs.

2. The interpretation of the term substantial US owner in the FATCA final regulations versus controlling person in the IGAs.

¹⁹³ M.H.Plowgian, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

¹⁹⁴ D.J.Joyce, "Drivers between the inconsistencies under the FATCA final regulations and the IGAs"(interview), 2015

The FATCA final regulations requires certain NFFEs to report information about their substantial US persons. A substantial US owner is any US taxpayer holding more than 10% ownership interest in an entity. In an IGA the term substantial US owner is replaced by the term controlling person. This means that the terms provide the same role. Under an IGA certain NFFEs must report accounts held by controlling persons. A controlling person is (in most cases) a US person with more than 25% ownership interest in an entity.

Under the Netherlands IGA the term controlling person is interpreted in a manner consistent with FATF recommendations. FATF refers to the definition as set forth in AML/KYC procedures. According to the AML/KYC procedures the term controlling person means a US person with at least 25% ownership interest.

The UK guidance notes provides that the threshold of ownership interest to classify as a controlling person is 25%.

3. The definition of an investment entity

Another notable inconsistency exists in the definition and interpretation of an investment entity. This inconsistency is the result of the inconsistent language used in the FATCA final regulations and the IGAs to describe the term investment entity.

The FATCA regulations provide three types of Investment entities (A, B and C).

- (D) *“any entity that **primarily** conducts as a business one or more of the following activities or operations for or on behalf of a customer:*
 - (9) *Trading in money market instruments (checks, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;*
 - (10) *Individual and collective portfolio management; or*
 - (11) *Otherwise investing, administering, or managing funds or money on behalf of other persons.*
- (E) *The entity’s gross income primarily attributable to investing, reinvesting, or trading in financial assets, and the entity is managed by another entity that is a financial institution. An entity is managed by another entity that is a financial institution if the managing entity performs either directly or through a third party service provider, any of the activities mentioned in (A).*
- (F) *The entity functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.”¹⁹⁵*

The IGAs provide for a somewhat simplified approach to the definition of an investment entity. Initially when the IGA was signed and released, the UK defined entities as investment entities only if they would perform activities described of type A investment entity.

In the Netherlands and UK IGA the word “primarily” is left out of the definition of an investment entity and replaced with the word “managed by”. Including “managed by” in the definition of what under the FATCA final regulations definition of investment entity would constitute as type B investment entity, leaves the impression that the UK tried to incorporate type A and type B investment entity into one harmonious definition. However the Dutch and UK guidance provide guidance as to what is the threshold to qualify as “primarily” conducting as a business, in both IGAs the threshold is 50%.

Throughout the analysis, two types of inconsistencies were detected. The first inconsistency type is an acceptable inconsistency between the FATCA final regulation and IGAs. This type of inconsistency is e.g. the classification of holding companies and treasury centers within the definition of a FI. Such

¹⁹⁵ Treasury regulations §1.1471-5(e)(4)

inconsistency is acceptable because the decision to include holding companies and treasury centers are based on local economic policy.

The second type of inconsistency is unacceptable. The second type of inconsistency entails that one definition has a different interpretation or meaning in different jurisdictions. For example, the threshold to classify as a substantial US owner or controlling person, and the definition investment entity. These inconsistencies are the result of government negotiations and cannot be justified. These inconsistencies should be eliminated and one harmonious definition should be obtained for each definition.

8.2.3 Which inconsistencies exist between the FATCA final regulations, the Netherlands and the UK IGA with regard to the due diligence and reporting?

The notable inconsistencies between the FATCA final regulations and the Netherlands and UK IGA with regard to due diligence and reporting are:

1. Review procedure for entity accounts

The FATCA final regulations provide for an inconsistent approach towards the due diligence procedure for entity accounts. The Netherlands and the UK IGA, allow FFIs and NFFEs to use publicly available information to determine the FATCA status of entity accounts. The FATCA final regulations does not provide the option to rely on publicly available information to determine the FATCA status of entity accounts. The option to rely on publicly available information is considered a burden relief for FFIs and NFFEs because FFIs prefer to use publicly available information than reaching out to clients and investors for new tax documentation.

2. The reporting deadline;

According to the FATCA final regulations, the reporting deadline for FFIs and NFFEs, is June 29, 2015 for filing year 2014. For reporting year 2015 and onwards the reporting deadline according to the FATCA final regulations is March 31. The reporting deadline for Netherlands FIs was January 30, 2015. The reporting deadline for UK FIs to report to HMRC with respect to US accounts is May 31, 2015.

3. The method of transmission;

According to the FATCA final regulations, FFIs and NFFEs must use FATCA XML v1.1., schema. The UK also opted to use FATCA XML v1.1., schema. The Netherlands chose a somewhat different approach. The Netherlands opted to use a specific Netherlands XML format as the method of transmission.

4. The requirement to submit nil returns

The FATCA final regulations does not require the filing of nil returns. The FATCA final regulations only require direct reporting NFFEs and sponsoring entities of direct reporting NFFEs to file nil returns. The UK does not require FFIs and NFFEs to submit nil returns. On March 11, 2015 HMRC released a statement with respect to reduced requirements of FATCA reporting. HMRC stated that nil reporting will not be a requirement for the IGA with the US. The Netherlands has not released language with respect to the requirement to file nil returns.

As aforementioned, throughout the analysis, two types of inconsistencies were detected. The first inconsistency type is an acceptable inconsistency between the FATCA final regulation and IGAs. The acceptable/justifiable inconsistency with respect to due diligence is the reporting deadline. Every jurisdiction already has its own tax systems and local privacy laws in place. Implementing FATCA in partner jurisdiction requires partner jurisdictions to adapt their local privacy laws to implement FATCA. Partner jurisdictions chose their reporting deadline based on what is practical and realistic taking their own government, tax and information reporting systems into consideration. Expecting every partner jurisdiction to implement a similar local reporting deadline is not practical, considering the systems that they already have in place.

Unacceptable inconsistencies with respect to reporting and due diligence include the due diligence of entity accounts, reporting method and the requirement to submit nil returns. Ultimately these inconsistencies should be eliminated, and Treasury and partner jurisdictions should work towards a uniform approach to these matters. This reduce burdens for stakeholders, FFIs and NFFEs.

8.2.4 What industry challenges are financial institutions and other in scope entities facing as a result of these inconsistencies?

The inconsistencies between the FATCA final regulations and the IGAs are the result of Treasury's bilateral approach towards FATCA. The industry challenges and concerns that were noted throughout the interviews and observation period will be discussed below.

The industry challenges that have emerged due to Treasury's bilateral approach are as follows:

1. Education and outreach;

One of the main challenges caused by the inconsistencies between the FATCA final regulations and the IGAs, is education and outreach. Getting everyone to understand and comply with the different requirements in different partner jurisdictions is an increased burden for FFIs and NFFEs. The scope of FATCA in itself is tremendously complex because it touches almost every institution in the world, from FFIs to NFFEs. Almost every organization has FATCA requirements to some extent.

Treasury's bilateral approach towards FATCA has resulted in many different versions of interpretations, requirements and regulations between the FATCA final regulations and IGAs which must be properly understood in order to comply.

2. Lack of guidance is another industry challenge;

Approximately 75% of jurisdictions, have not published their guidance notes yet. Without guidance FFIs and NFFEs are not able to comply with all their FATCA requirements because an IGA does not provide all the necessary information to guide FFIs and NFFEs. For example, the Model 1 IGA does not provide the reporting deadlines, or the method of transmission. Thus, partner jurisdictions FFIs and certain NFFEs rely on guidance notes to receive information about their reporting requirements.

Another potential challenge that arises from the general lack of guidance is that partner jurisdictions FFIs are following other partner jurisdictions guidance. FFIs in partner jurisdictions are reaching out for guidance since their partner jurisdiction have not yet released its own guidance. This puts the restive FFI at risk for misinterpreting the local IGA.

3. Monitoring;

Another challenge caused by the inconsistent approach towards FATCA, is monitoring and being up to date with new FATCA publications worldly. One of the key aspects in achieving total compliance under the FATCA final regulations and the IGAs, is by continuously monitoring legislative updates, including publications or newly published guidance. FATCA is a moving target and the regulations are in continuous development. Keeping track of all the changes is an increased burden for FFIs and NFFEs.

4. US citizenship renunciation.

Stakeholders have expressed concerns about how the IRS will deal with US taxpayers that in previous years did not report tax information correctly. Stakeholders that in previous years failed to report their financial assets properly are now concerned with the legal persecution and penalties they might be facing. Besides the fact that FATCA is a very time consuming and costly regime, the aforementioned stakeholders concern has largely contributed to the high number of US citizenship renunciations. The number of US citizenship renunciations has been growing since FATCA went into effect.

8.2.5. How can the challenges caused by the inconsistencies be addressed in order to mitigate the burdens placed upon financial institutions and other in scope entities?

After having analyzed the inconsistencies and the industry challenges that have emerged from the inconsistencies between the FATCA final regulations and the IGAs, the following alternatives are proposed to address the industry challenges:

1. Deadline with respect to guidance notes

A possible solution for the general lack of guidance in partner jurisdictions with an IGA in effect, is implementing deadlines as part of a synchronized effort to push countries to publish guidance notes in partner jurisdictions. Since there isn't a deadline for countries to publish guidance notes, introducing a deadline and including such in an IGA might be a solution for this issue. Even though this might be ideal, pushing foreign governments with implementing deadlines for guidance notes, is not practical. This process depends on foreign governments legislative processes. Another factor is that foreign governments usually like to have say in legislative processes and do not like being given instructions.

2. FATCA committee

The lack of guidance and education and outreach challenge can be addressed by developing an ongoing FATCA committee. The FATCA committee will provide an indirect solution for the industry challenges faced. The committee will enable stakeholders, US legislators, and foreign governments, to meet periodically and discuss the practical challenges that currently exist. Currently, Treasury does not have such a mechanism in place that provides for ongoing dialogue between US legislators, foreign jurisdictions and stakeholders.

3. Transitional rules

Since FATCA went into effect, many stakeholders expressed concerns about how the IRS will deal with US taxpayers that in previous years did not report tax information correctly. Stakeholders that in previous years failed to report their financial assets properly are now concerned with the legal persecution and penalties they might be facing. This has led to many US citizenship renunciations. The high number of renunciations are mainly that of Americans living abroad and not wanting to comply with FATCA.

US citizenship renunciations can be addressed by developing transitional rules that provide relief for US taxpayers that are FATCA compliant and acting in good faith towards complying with the FATCA requirements. The relief should apply to years prior to 2014, and it should relieve all US tax liabilities prior to 2014. Such relief should be provided as part of the transitional rules of FATCA. These transitional rules would work as an incentive to get all stakeholders onboard and tackle the increasing number of US citizenship renunciations. Ultimately this approach would positively impact the tax revenue, as this will make US persons and tax evaders less likely to try to relocate their financial assets to jurisdictions that have privacy laws that doesn't allow the international exchange of information or renounce their US citizenship.

However with the first reporting deadline so close by and the US budgetary constraint it will be less likely that these developments will take place in the near future but after the first reporting deadline, there might be certain developments with respect to the regulations.

8.3 ADDRESSING THE CENTRAL QUESTION

The abovementioned key questions were derived from the following central question, which was also discussed in the introduction:

How can the industry challenges caused by the inconsistencies between the FATCA final regulations and the IGAs be mitigated, with respect to financial institutions and other in scope entities that are active in jurisdictions with IGAs in effect?

Based on the answers of the key questions, can be concluded that the industry challenges that emerged as a result of the inconsistencies between the FATCA final regulations and the IGAs can be addressed by developing a FATCA committee and by developing transitional rules. The FATCA committee will indirectly address industry challenges. The transitional rules will provide relief for stakeholders and will tackle the high number of US citizenship renunciations.

8.3.1 FATCA committee

To date, the US does not have a committee in place that provides continuous discussion on the FATCA challenges. One of the proposed solutions to address the industry challenges discussed previously, is the development of an ongoing FATCA committee. The most effective method of getting practical feedback that Treasury used to develop the FATCA final regulations, was during interactions with people from stakeholders where they explained in factual scenarios what the practical challenges were.

A FATCA committee will indirectly address the education and outreach challenge through the collaboration of legislators, partner jurisdictions, and stakeholders. Ultimately, stakeholders are in the best position to discuss effective methods to improve the regulation. The committee will enable stakeholders, US and foreign legislators, to meet periodically and discuss the practical challenges that currently exist. The FATCA committee will also provide the legislators with the opportunity to communicate deadlines and explain FATCA requirements.

8.3.2 Transitional rules

Since FATCA went into effect, many stakeholders have expressed concerns about how the IRS will deal with US taxpayers that in previous years have not reported tax information correctly. Stakeholders that in previous years have not reported their financial assets properly are now concerned with the legal persecution and penalties they might be facing. This has led to many US citizenship renunciations. The high number of renunciations are mainly that of Americans living abroad and not wanting to comply with FATCA.

To address stakeholders concerns and reduce the amount of US citizenship renunciations, Treasury should develop transitional rules that provides relief for stakeholders that are FATCA compliant and acting in good faith towards being FATCA compliant. The transitional rules provides an incentive for US taxpayers to report their assets without the concern of being legally persecuted in the future for not having complied with the US taxation system in previous years. The transitional rules should be included in the FATCA final regulations and the IGAs. US taxpayers that are FATCA compliant and are acting in good faith towards complying with the FATCA requirements, should be provided relief for years before 2014 with respect to their US tax liabilities. As the first reporting period according to FATCA is 2014, it is only fair to provide such a relief as an incentive to get all stakeholders onboard.

Since these terms are beneficial for stakeholders and FFIs and it does not require effort from the partner jurisdiction, the regulation would most likely fall within the most favored nation clause that states that if during an IGA negotiation, more favorable terms have been reached, these favorable terms would automatically apply to all partner jurisdiction.

Thus, these transitional rules would work as an incentive to get all stakeholders onboard and tackle the increasing number of US citizenship renunciations. Ultimately this approach would positively impact the tax revenue, as this will make US persons and tax evaders less likely to try to relocate their financial assets to jurisdictions that have privacy laws that doesn't allow the international exchange of information or renounce their US citizenship.

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ANNEX A

INTERVIEW MICHAEL PLOWGIAN

Tax Law and Economics interview regarding FATCA

Drivers between the inconsistencies between the FATCA final regulations and the IGAs

Date: March 24, 2015

Interviewee: Plowgian, Michael

Interviewer: Guda, Ayoni

Introduction

This Q&A interview provides insight and information into the drivers of the inconsistencies between the FATCA final regulations and the Intergovernmental Agreements (“IGAs”) by Michael Plowgian, hereto referred as (“M., Plowgian” or “interviewee”). Michael Plowgian is a principal in KPMG’s Washington National Tax Office for International Tax. Prior to joining KPMG, Michael Plowgian was a Senior Advisor on Base Erosion and Profit Shifting (BEPS), at the Organization for Economic Co-operation and Development (OECD). Michael was also involved in the ongoing work of the OECD and G20 to establish a single global standard for automatic exchange of information based on FATCA. Prior to joining the OECD, Michael was an Attorney Advisor in the Office of the International Tax Counsel at the US Department of the Treasury. Michael was responsible for a wide range of U. international tax guidance, and was a principal drafter of the regulatory guidance under the tax reporting and withholding provisions commonly known as FATCA. Michael also developed, negotiated, and drafted the IGAs to facilitate the implementation of FATCA.

The person conducting the interview is Ayoni Guda, hereto referred as (“A., Guda” or “interviewer”), an International Tax Intern at KPMG LLP, New York office. The interview will take place through conference call in the KPMG LLP New York office. Notes will be taken throughout the interview, whereas the interviewer will incorporate these notes into a document.

Interview

1 What are your views the drivers of the inconsistencies between the FATCA final regulations and the IGAs?

M., Plowgian: “The IGAs were signed based on negotiations with partner jurisdictions which is the main reason for the inconsistencies. Every IGA is negotiated with other governments. It might be easier to breakdown some of the inconsistencies. For example on the issue of what is a substantial US owner and as to what is a controlling person. The issue is that we had a statutory provision threshold that provides a 10% ownership whereas the IGA provides for controlling person based on AML/KYC standards in the partner jurisdiction which often, not always, is 25%. It is a matter of negotiation and a practical matter. What other governments were trying to do was to reduce burden for financial institutions, so by linking it to the AML/KYC standards they were trying to link it to systems that institutions, in theory, were already doing and so that was a key element of the negotiations.”

A., Guda: “I understand that another driver might also be that every country has it domestic laws so they don’t just want to go ahead and adopt the regulations as they are in the US. They may want to adopt their own approach that fits with the domestic laws that they currently have in place. Most countries took their own approach on the IGAs because they have their own domestic

laws in place that would otherwise prevent the international information exchange and don't want to go and ahead and adopt the US approach, what are your views on that?"

M., Plowgian: "Well that to one extent is the drivers for the IGAs existing at all. In many cases most institutions in many jurisdictions could not comply legally with the regulations as they stood. And so we needed to have a different mechanism for compliance, that's why the different Model IGAs have been implemented. But from a financial institutions perspective once the IGAs are in place, the FI wants them to be as consistent as possible. And certainly the US' position has been to try to make the agreements as consistent as possible, to the extent that the terms vary there may be more beneficial provisions in a later agreement, the Treasury makes that available to governments that has signed agreements earlier that's how the US wanted to minimize the differences between the IGAs."

2 Why has US Treasury drafted two Model IGAs and has not taken a uniform approach to these treaties? And do you believe that if the US Treasury adopted only one Model IGA, the implementation of FATCA would have a different outcome?

M., Plowgian: Just the chronology of it was that the Model 1 was developed first obviously and that is the Model that really facilitated the development of the OECD Common Reporting Standard. And the view was that that really provides for a more consistent treatment. Model 2 was really developed in response of two concerns that governments had. One was that governments just had a fundamental opposition to automatic exchange of information and would not agree to a Model 1 IGA, and so in order to accommodate that and to still enable FIs in those jurisdictions to participate we had to develop a Model 2. In most of those countries the local laws would have prevented the FI to report information to the IRS in absent of the IGA. So it was not that the jurisdictions would not allow the information exchange but the governments would oppose information exchange on principal. The other concern for the some other countries was a government burden one, they did not want to create the systems to gather the information from their financial institutions to exchange with the IRS. They didn't really have any philosophical concerns, it just sounded hard to them."

3 Why have certain countries opted for a Model IB IGA, instead of a Model IA? Reciprocal vs. nonreciprocal? Wouldn't all countries involved want to benefit from taxing local taxpayers with accounts offshore?

M., Plowgian: "In some cases jurisdiction don't impose income tax and therefor the US cannot send those jurisdictions information because in the US treaty and TIEA standard information can only be exchanged for purposes of administering and enforcing the income tax laws of the partner jurisdiction. So for example in the Cayman Islands, the US cannot send information because under the Tax Information Exchange Agreement there is no income tax law for the Cayman Islands to enforce."

4 What is the reason that some countries adopted the 5th category of FIs in their FFI classification per the US FATCA final regulations and why have some countries adopted just four categories?

M., Plowgian: "This one is complicated in my view. As a policy matter the reason the regulations sweep in holding companies and treasury centers is because you don't want to have a situation where a financial institution especially a bank, could set up a holding company and route all its US investments and investments that give rise to withholdable payments to that holding company and say that no withholding applies. In the IGA context that is not really a concern because withholding doesn't apply to financial institutions in those jurisdictions anyways so whether a holding or a treasury center is or is not a FI doesn't really matter.

So it is not really same issue as it is under the regulations. So then why the U.K. and Ireland swiped in those types of entities under an FI, the short answer is that I don't know. In fact as you know, the UK has recently changed its mind on that. My understanding from talking to other governments involved in that

decision was that originally it was thought that it would benefit FIs by allowing holding companies of fund groups or a bank holding company to register as FIs with the IRS and then basically allow them to do a consolidated compliance program at the level of the parent company or things like that and if they weren't included as FIs then they could not register with the IRS as FIs. That was my understanding from talking with other governments but the short answer is that I don't really know why they do it."

5 What are in your point of view the biggest industry challenges with respect to the implementation of FATCA?

- **From the IRS perspective**
- **And from a stakeholders perspective**

M., Plowgian: "This one is also a bit hard for me to answer. To some extent the very answer is the very scope of FATCA and that it touches almost every entity on earth in theory and just getting the outreach to various non-US entities that have financial accounts with non-financial institutions and helping them understand why this matters and why they need to figure out what type of entity they are and how they even do that, a lot of it is an education and out-reach challenge and falls on non-US institutions. Of course US FIs also have to do that but it is easier to explain to their clients than it is for non-US financial institutions and that is changing as FATCA is implemented in local law. Another enormous challenge for financial institutions is that most IGA countries have not issued local law. And that is a big big problem because it basically puts them in a legal limbo because under existing law in their jurisdiction they still cannot comply with FATCA but there is an agreement that says that they have to comply so it is very confusing."

6 The final regulations have been drafted twice in an attempt to make FATCA more comprehensive. Have the challenges in question 6 been addressed after the second set of regulations? If not, what alterations do you think is necessary to address these challenges?

M., Plowgian: "No, and to some extent there's nothing the US can do about the biggest challenges. The biggest challenges is the lack of guidance under local law and education and outreach and changing the US regulations wouldn't do anything to any of those challenges. I think the US Treasury and IRS have done as much as they can to try to reduce burden given both the words and the intent of the statute the regulations have done a lot to try and reduce burden although there are a lot of complaints on how complex the regulations are but in large that's driven by efforts to reduce the impact of the statute or the impact that the statute would otherwise have on financial institutions. So there is a sort of tradeoff between simplicity of the regulatory and statutory language and burden on financial institutions."

7 Now you would say that burdens have been shifted from governments to financial institutions to identify taxpayers?

M., Plowgian: "Yeah, and conceptually that is really the heart of what FATCA is and that was a debate that has been going on the past 20 years and it was something that was the key insight of the QI regime. Now the QI regime was intended to be a source withholding regime not a regime for identifying US resident account holders so I don't want to oversell the similarity but the key insights of both regimes is that financial institutions are in the best place to identify their account holders and that drove the development of FATCA."

It's interesting to me because 20 years ago it was not clear at all that conceptually that would become the norm, but it clearly has been, the norm that financial institutions identify account holders for tax purposes."

8 So what you're saying is that the US has done everything possible to reduce burden and that now it is up to local law and partner jurisdiction to provide for a way for relief or to relieve burden?

M., Plowgian: “I would say at a big picture level that’s right. But as we go along we can’t provide people from getting smarter so I think that you may see changes or improvements to the guidance in the future as new issues come up and as the various bugs in the system gets worked out. But as the bigger picture I say yes, the bigger concerns are making sure that partner jurisdictions get their own implementing guidance in place and help financial institutions do the outreach that’s necessary for account holders and help them understand that this is something we have to do and this is why.

9 With the reporting deadlines very close by do you expect guidance’s to be published sooner rather than later? There isn’t a deadline for partner jurisdictions to publish guidance notes is there?

M., Plowgian: “No, there is not. Under the IGAs and regulations, and I hate to speculate as to what will happen, but Treasury has said as long as countries are moving forward in good faith and doing everything they can to get those IGAs implemented, they will treat the jurisdictions as having an IGA in place. What the standard is for determining when countries are not acting in good faith, I don’t think anybody knows that and if or when Treasury would actually revoke an IGA that’s been agreed in substance. So those are still big areas of uncertainties and it’s something that causes a lot of anxiety for financial institutions as well.”

10 What is your view with respect to countries using/relying on other countries guidance notes? Do you see any risk/potential challenges from doing so? Does this contribute to the inconsistencies?

M., Plowgian: “Yes, I do think that is somewhat risky, not least because the same word can mean different things in different countries legal systems and so I do think that actually translating the concept of the guidance needs to be done rather than just relying on the words.

For legal advisors that do not know what other countries guidance will say, I just don’t know how much weigh you can put on other countries saying that they will follow other countries guidance notes, is it going to translate the concept? What exactly does that mean and I just don’t think it will give financial institutions allot of comfort.”

11 In your experience, how has the co-operation been between stakeholders and the US Treasury?

M., Plowgian: “Treasury and the IRS were definitely trying to minimize burden consistent with the language of the statute. The interesting thing is that as a government official, I learned a lot of what is effective and what is not-effective sort of with interaction with the government. In the beginning allot of people came in to the IRS and the Treasury and say please make FATCA go away. But that was not possible because it was a statute and there was nothing the Treasury and IRS could do to make it go away and so that was clearly not-effective. Whereas some people recognized that it was not going to go away and provided very concrete factual scenarios and really helped Treasury and the IRS understand the practical difficulties and what it would actually mean to do X, Y, Z, especially for bank personnel or insurance companies personnel and those types of interactions were the most helpful and the most effective to bringing changes to the guidance. And in fact in many cases it was not even tax lawyers who were the most effective but it was most often operation people who were able to explain this is the impact of this or that rule on operation.”

M., Plowgian: “The privacy and the data protection at least in the EU also continues to be a real issue especially for the Common Reporting Standard (CRS), I don’t know if you’ve looked into that.

It’s a very difficult issue. Conceptually, not just as a legal matter but as a political philosophy matter, it’s a very interesting.”

12 That's another very interesting thing, the role of the CRS and the implementation of FATCA, I know that you've also drafted the CRS so how come they took a different approach to CRS and FATCA and why is the scope of the CRS wider than that of FATCA?"

M., Plowgian: "Well, to some extent the difference is just a difference between a bilateral and a multilateral regime. So for e.g. the local financial institution exception under FATCA just doesn't make any sense in the CRS just because local FIs still have to report on non-residents and everybody is reportable under the CRS as a non-resident so just the exception collapses on itself.

Same thing with looking through reporting active NFE's that analogist to reporting on US corporations regardless if they're in an active business and those kinds of things. Some of the differences are just political so the absence of the \$50,000 minimum threshold is just a reflection that for many countries they really care about an account that's under \$50,000 and they didn't want to be bound by the US congresses and Treasury's determination that those accounts are not interesting. So I think those two types of issues, the multilateral vs. bilateral and political sovereignty type issues really drive most of the differences."

A., Guda: "But do you not think that because of those big differences, the coordination of FATCA and CRS due diligence requirements for example has become a greater burden? I believe that in the end one synchronized approach in operations would relief financial institutions of great burden"

M., Plowgian: "Yes absolutely, and the hope of the CRS at least of the OECD was that the rules would be consistent enough that financial institutions would leverage what they were doing for FATCA to implement the CRS. To some extent that is true but for a lot of financial institutions they would have to have if not completely separate processes at least different projects that are then reconciled as much as they can but for many financial institutions, they are going to have different on-boarding forms for FATCA and the CRS and things like that because it does require a collection of different information. I guess everyone's hope was that it would be quite similar but just because of the practicality of multilateral negotiations they weren't as similar as people had hoped."

INTERVIEW DEIRDRE JOYCE

Tax Law and Economics interview regarding FATCA

Drivers between the inconsistencies between the FATCA final regulations and the IGAs

Date: March 13, 2015

Second round of interview on April 29, 2015

Interviewee: Joyce, Deirdre

Interviewer: Guda, Ayoni

Introduction

This Q&A interview provides insight and information into the drivers between the inconsistencies under the FATCA final regulations and the Intergovernmental Agreements ("IGAs") by Deirdre Joyce, hereto referred as ("D. Joyce" or "interviewee") an International Tax Senior Manager, Alternative Investments, FATCA expert at KPMG LLP. The person conducting the interview is Ayoni Guda, hereto referred as ("A. Guda" or "interviewer"), an International Tax Intern at KPMG LLP, New York office. The interview will take place through a conference call at 2PM Eastern Time, whereas the interviewee was in the KPMG LLP, New Jersey office and the interviewer was in the KPMG LLP, New York office. Notes will be taken throughout the interview, whereas the interviewer will translate these notes into a document.

Interview

1. What are in your point of view the drivers between the inconsistencies under the FATCA final regulations and the IGAs?

D., Joyce: "First of all, the nature of dealing with sovereign nations have largely contributed to the inconsistencies. Every nation has its own take on FATCA and the IGAs, they don't want to just go ahead and say we adopt all the US regulations without taking our own rules in consideration. Jurisdictions have their own rules and processes in place that they must coordinate with FATCA before they approve the IGA. That's what you see in a Model 1 or Model 2 Agreement, but more and more countries are getting inspired by these agreements when they realize how many countries are enacting FATCA and they decide to implement it too to benefit from it.

I don't think the IRS would have been able to get the rest of the world to get on board with FATCA if they hadn't had the IGAs and to allow local countries through the IGAs to have a little bit of say in what's happening. Because if it was just the IRS going these are the rules, here are our regulations take it or leave it, the whole world would have pushed back a lot more and that was my first reaction when the final regulations first came out, I said I can't believe that the rest of the world is going along with this but I can understand why people want to find tax avoiders through this whole process but you know its whether you're talking about it internationally or even here in the US its every government wants to have its own say and be able to say that we represented your interest by participating in the process."

2. What is the reason that some countries adopted the 5th category of FIs (holdings and treasury centers) in their FFI classification per the FATCA final regulations and why have some countries adopted just four categories?

"Industry rules also have big effects on the inconsistencies between the regulations and the IGAs. Industry rules with respect to financial center. Mostly countries that are covered by financial centers, such as United Kingdom ("UK"), Luxembourg and Ireland, and deal with these issues, have a different approach on the IGAs than countries that are not covered by financial centers. For example the UK guidance specifically addresses holding companies and treasury centers, since these institutions are

largely covered in the UK. The approach of such countries in the IGAs are often much deeper than that of countries that have less financial centers.”

A., Guda: “But why were they able to get the CRS to do so in that case, because CRS is a multilateral agreement.”

D. Joyce.: “I don’t know, I don’t know as much about the CRS. I mean part of that is through the OECD and that’s already an organization, it can just be the driver of the legislation where the OECD is already an organization where different countries have agreed that they’re going to cooperate and agreed that they will have some type of consistency in how they do things whereas the other alternative what the IRS could have done is they could have gone to the OECD and say lets work it all out and they didn’t do it that way because the US is the US and they are one of the early adopters of the OECD. Globally that problem would have been a better approach for the industry and for those who have to comply with FATCA if the US would have gone to the OECD and have something that is more consistent. That would have made it easier for everyone and it would have made the cost be significantly less but since they didn’t do it that way and again to your answer with the CRS, I think it’s because there’s history for having cooperative and working out these issues on a cooperative basis. That’s my take on it.”

A., Guda: “With respect to due diligence and reporting, the IRS has published three XML schemas, but the Netherlands, e.g. took its own approach and wants to do a specific Netherlands schema. This also contributes to the inconsistencies, do you believe that if there was just one XML schema, the data processing would be easier also for the IRS?”

D., Joyce: “I think so, I think the more harmonization and consistency you have, the better. I mean it could not only be the rules but it can also have something to do with the systems and the way they are set up. I know there are certain data that needs to be collected for some of the other countries that’s why they have a slightly different schema but again it goes to the more things that are different, the more difficult it is and it creates challenges not only for the FFIs who are trying to do reporting but it creates challenges for the service providers who are trying to create software that will help the clients do the reporting, it sort of goes across the board there.”

A., Guda: I expect that on a short term basis the most important countries or better said almost all countries worldwide will be covered by the IGAs and by the CRS, since the CRS has called on all countries to adopt its standards, what are your views on this?”

D., Joyce: “Well I don’t think they have much of a choice. FATCA is too far along and countries go into these agreements to benefit from information exchange. If they don’t go into these agreements they won’t be able to benefit from the information exchange and as a result they won’t receive information in order to tax domestic persons. So as countries see how many countries are adopting these rules, they go ahead and start negotiating these agreements too. These initiatives have basically shifted government functions to financial institutions. Governments used to be in charge of the auditing and identification of people holding accounts offshore. Now it has relieved itself from these burdens and put it on financial institutions to adopt due diligence and compliance obligations to identify US persons.

My thoughts in 2012 when FATCA was enacted was that there would be a lot more controversy against FATCA by persons and by other jurisdictions since FATCA places a great burden on financial institutions to adopt new processes and systems into the business environment which places big costs for these institutions. By that time it still wasn’t clear whether the costs would outweigh the benefits.

3. Why has US Treasury drafted two Model IGAs and has not taken a uniform approach to these treaties? And do you believe that if the US Treasury adopted only one Model IGA, the implementation of FATCA would have a different outcome, say e.g. like the CRS?

D., Joyce: "They tend to use the Model 1 and a Model 2 is driven by local privacy rules which either doesn't allow the local government to exchange information with the IRS or their disclosure requirement. It's really more driven by the local countries rule sets."

4. If the goal of the US Treasury and IRS was to create a uniform approach with respect to the final regulations and the IGAs, why does the term "investment entity" in the IGA differ from that in the final regulations?

D., Joyce: "I don't know. I don't know why they would refine the terms in the IGAs except for if US Treasury had less input in the writing of the IGA process than in the regulatory process."

5. In your view, what are the biggest industry challenges with respect to the implementation of FATCA?

- From the IRS perspective
- From a stakeholders perspective"
- For FFIs and NFFE's

D., Joyce: "From the IRS perspective, it's going to be what they are going to do with all this data once they get it. Do they have the systems to process and to track? For years they've been trying to set up K1 matching, where they look at tax returns because they get the 1065's from partnerships with K1's so they have the tax payer information and I don't think they've ever really done a good job of matching the K1 information to the 1040 tax return information. I think there's been some other initiatives that they've had that they collect information, and someone looks at it at a certain level but we don't know what happens, nothing ever comes out of it. There's some reporting that got done from I think for some other informational returns and information attached to tax returns and it's like they're put in there and no one ever hears anything from the IRS about it so I'm not sure that they've got the systems to collect, process, and analyze all the data they're getting, already they have problems with the budget cut so how are they going to do collection or enforcement honor all the FFIs with the limited resources that they have right now."

And from a stakeholder's perspective, I mean with respect to the practicality it seems like there is always rules and rules being changed. So if you're dealing with US rule sets, maybe I'm saying it more because we are on the professional side but I think if you had a multinational, either a fund or a bank, dealing with different rule sets, differences in the definitions, differences in the dates, and the procedural steps that have to be followed and with everything being so late it makes everything really hard to make it feel like you've got a handle on it because the minute you know something, ten minutes later it changed.

For FFIs it's the same thing, even though it's been around for a long time, since 2010, the guidance was so late in coming out, the regulations were so late at coming out, everything has been delayed, here we are a month away from reporting and there are still things we're trying to figure out, like how are we going to do the reporting."

6. In your view, what are the industry challenges that emerged as a result of the inconsistencies between the final regulations and the IGAs?

D., Joyce: "Trying to keep track of it all. Monitoring or trying to remember if you got funds in the Cayman, Australia, BVI, UK, trying to remember the different dates and if you are a large organization and if you are in the Netherlands too it could be three or four different dates that they have to remember and on top of the different rule sets trying to have a baseline of what they're going to be doing for everyone so that they're compliant with the different regimes."

7. The final regulations have been drafted twice in an attempt to make FATCA more comprehensive. Have the challenges in question 6 been addressed after the second set of regulations? If not, what alterations do you think is necessary to address these challenges?

D., Joyce: "I think a lot of what happened with the second set of final regulations, they were trying to harmonize some of the final regulations with what was in the IGAs and I know that a lot of the difference between the proposed regulations and final regulations were to try to simplify things, there they were trying to listen to industry comments in both. In the final regulations try to harmonize the regulations more with chapter 3 and chapter 4 and IGA definitions. I think they're trying but it's such a massive amount of detail that needs to be harmonized that I think they are trying to but, it's just not all completely there."

8. What is your view with respect to countries using/relying on other countries guidance notes? Do you see any risk/potential challenges from doing so? Does this contribute to the inconsistencies?

D., Joyce: "I think we need guidance notes just because once you're under an IGA, they aren't bound by the regulations so if they aren't going to be saying well were going to rely on the US regulations then they need to provide some guidance. I think if you have a different country relying on for example the UK guidance notes, which we've seen quite a bit, I mean its useful in that it provides some consistencies with respect to some jurisdictions but I still think there is going to be risks or challenges because if the country hasn't published its own, even if it's the same as the UK it leaves it unknown as to is it going to be accepted on all forms, is it going to be identical, or are there gaps. It adds to the overall pain in the implementation."

9. In general it is known that the US Treasury and the IRS tried to relief burden for FFIs by cooperating with stakeholders and drafting the final regulations. Do you know if the IRS has a FATCA commission in place to tackle all the challenges that will emerge in the future?

D., Joyce: "I am not aware of them having anything ongoing like that. I know in the past they've had common periods so where they've issued either the rules or the regulations, there's been a window of where they solicit information whether if its written briefs on these are the issues we've seen and there've been hearings too where they've had feedback. I think it would be good for them to have an ongoing dialogue because otherwise how else are they going to resolve these issues. I am not aware of them having a mechanism in place to have an ongoing dialogue other than people writing whoever it is, the assistant depute or commissioner in charge of FATCA saying this is a problem and hoping that there are enough letters on the same issue that they would address it."

10. If not, do you believe that a FATCA commission which would include members of Treasury, IRS, stakeholders from the US and partner jurisdictions, would be able to better address industry challenges faced up to now?

D., Joyce: "It may help, I may be cynical in thinking how to get all these countries to cooperate. But this might change with the CRS which might harmonize. That might put pressure on the US to harmonize with the OECD. So there's going to be some tension there to see how that's going to play out and seeing how well the OECD is going to be able to come out with guidance that different countries can agree on."

I think it's going to take time at this point, because we're so close to reporting, reporting is happening and starting in a month and so I think it's almost too late for there to be round tables and talking about exactly how things are going to make the system better right now but I think maybe as the rules go into implementation there's still an opportunity for there to be improvements on the systems but I don't know whether or not they even have follow up plans commission to address some of the issues that have come up."

11. Treasury, IRS, nor local governments have adopted deadlines for the implementation of guidance notes. This is generally one of the main issues relating to FATCA. Do you believe that if a synchronized effort were to take place that would push countries to adopt a deadline to publish guidance, this would facilitate the implementation of FATCA?

D., Joyce: "I think it would be hard just because in some countries the legislation and the guidance has to go to the legislator to be finally effective. Then you're dealing with pushing foreign governments around and the whole governmental process which can be difficult especially in smaller countries where they may have so many other things to deal with this is a lot harder for them to make it a priority. The UK obviously made this a priority because it impacted so many of their industry and Cayman Islands too, there are so many funds in the Cayman Islands that they've really focused on that, but there are some other countries where I don't think that they would be as receptive to try to come to such process.

I think what would end up happening with countries that have no guidance, the funds and FIs in those countries are a little bit out of loss so it could end up moving their economy.

Let say you have a French FI but there's no French guidance, they might decide that we'll just change where operating and move were because the market is so fluid now, you don't necessarily have to be in one jurisdiction. It can hurt the countries economically if some of the countries especially in the AI space, where banks that have to serve the local customers, they can just move their business to a jurisdiction where there is more guidance or to a jurisdiction where there are guidance that are more favorable to them."

12. If so, do you believe that this is possible by including this in the IGA? The most favored nation clause would allow this potential regulation to apply to every IGA. What are your views on this?

D., Joyce: "It would be hard to get so many different countries to vote and then you'd have to US might being asked to change something that they don't want to change. And I don't know where things stand with the IRS or with the US entering into the CRS and doing that. I mean that would be a common way of resolving this issue but even that is a very slow process to get all the governments to do something.

Based on the most favored nation clause, it is something that could be incorporated in the IGAs and if its beneficial, it could be a mechanism to create the committee but I have a feeling and it could be that after we go through the first reporting season or the next year or so as the different rule sets play out, we might see something like that.

My thoughts is whether the IRS are going to set up a commission and whether they have any process for that because they also have the budgetary constrain and are they just addressing it by commentaries being sent to them which is still an ongoing process which you see in the tax alerts once in a while that X, Y, Z person whether it's a law firm or an accounting firm on behalf of their client's send a letter to the IRS to say that this is a problem in the regulation. The service process for that is to consider those and if they get enough of them or think it's a valid concern they might consider making a change but it's a whole process to get the regulations, drafted, amended, and changed so I don't know where they stand on that, maybe they want to give it some time to, I don't know."

INTERVIEW BENNO OLDENHOF

Tax Law and Economics interview regarding FATCA

Drivers between the inconsistencies between the FATCA final regulations and the IGAs

Date: April 30, 2015

Interviewee: Oldenhof, Benno

Interviewer: Guda, Ayoni

Introduction

This Q&A interview provides insight and information into the drivers between the inconsistencies under the FATCA final regulations and the Intergovernmental Agreements ("IGAs") by Benno Oldenhof, hereto referred as ("B, Oldenhof" or "interviewee"), Tax Partner at Baker Tilly, Aruba. The person conducting the interview is Ayoni Guda, hereto referred as ("A., Guda" or "interviewer"), an International Tax Intern at KPMG LLP, New York office. The interview will take place at KPMG LLP at 2:00 PM Eastern Time, through a conference call. Notes will be taken throughout the interview, whereas the interviewer will translate these notes into a document.

Interview

1 What are in your views the drivers of the inconsistencies between the FATCA final regulations and the IGAs?

- **With respect to FFI classification**
- **With respect to due diligence and reporting**

B., Oldenhof: "If a country wants to cooperate and wants to enter into an IGA with the US, then a sort of reward is given by providing certain reliefs in the IGAs with respect to some FATCA obligations. Jurisdictions that do not opt to enter into an IGA with the US do not benefit from the reliefs under an IGA, because they are subject to the FATCA final regulations.

In my views the inconsistencies are the result of some sort of compensation given to partner jurisdictions for their cooperation. So, if you want to cooperate by entering into an IGA, you'll receive the freedom of interpreting definitions not discussed in an IGA according to local laws. The IGA negotiations also form part of the compensation, by giving more freedom of interpretation and by providing reliefs.

Besides giving compensation to countries that cooperate, the IGAs also have another function. FATCA is a national law of the United States, and national law does not apply in different jurisdictions. There may be legal barriers in jurisdictions trying to comply with FATCA. So the IGAs were introduced to remove legal barriers that would otherwise prevent the international exchange of information. The inconsistencies are also a matter of government negotiations."

2 Why has US Treasury drafted two Model IGAs and has not taken a uniform approach to these treaties? And do you believe that if the US Treasury adopted only one Model IGA, the implementation of FATCA would have a different outcome, say e.g. like the CRS?

B., Oldenhof: "The real question is why they haven't developed one uniform Model IGA. It's because US Treasury and the IRS wanted to give partner jurisdictions the opportunity to choose which Model IGA they prefer. It is purely a service to countries so far. FATCA is a pretty one-sided legislation.

.In my opinion, the inconsistencies are the result of countries having different guidance notes that discuss the same matters under their own interpretation. If you give partner jurisdictions the opportunity to choose between the Model IGAs, the US must ensure that the partner jurisdictions are capable of implementing

FATCA. When countries draft their own guidance notes independently, it can conflict with other countries' guidance that is when the problem starts. A good example is the OECD Model Convention.

The OECD Model Convention consists of one Model which is used by all countries and one explanatory notes. Every country is different, and there will be some small nuances between the treaties depending on the economic situation of the country. The key element for the uniform approach is that there is one Model Convention and one explanatory notes that are used by every jurisdiction worldwide.

What in my views would be ideal, is that CRS is widely implemented by every country in the world with the same explanation or guidance notes and that everyone applies the same guidance in the future. If that were the case you wouldn't even need FATCA anymore.

If the US keeps FATCA the risk is there that every country wants to adopt their own FATCA like regime which would ultimately result in countries having different information reporting regulations. What will eventually happen once CRS starts its process of implementation is that it will apply to every jurisdiction. Jurisdictions that do not participate will be economically boycotted. In my opinion FATCA can also be removed, because a problem will arise if countries have different information-reporting regime in place. That's why CRS is a good solution because it provides harmonization and cooperation of multiple jurisdictions."

3 What is the reason that some countries adopted the 5th category of FFIs (holdings and treasury centers) in their FFI classification per the FATCA final regulations and why have some countries adopted just four categories?

B., Oldenhof: "I think it has to do with the fact that certain countries are covered by financial centers. Netherlands is a country where many foreign companies are based purely because Netherlands has so many tax treaties with other jurisdictions. So as a country covered by financial centers you do not opt to such holding companies and treasury centers under the definition of a FFI, based on an economic perspective purely to relief burden for these financial centers. Otherwise you risk the holding companies relocating to a jurisdiction where there are more favorable regulations.

I'm pretty sure that other countries, including the UK, covered by financial centers, does not include the 5th category of FFIs. It is a sort of prerequisite for countries covered by financial centers, not to include holding companies and treasury centers under the definition of a FFI. Because doing so can be a huge setback for the economy and the financial centers in that country. It has to do with economic activity and the international service center of the jurisdiction."

4 If the goal of the US Treasury and IRS was to create a uniform approach with respect to the final regulations and the IGAs, why does the term "investment entity" in the IGA differ from that in the final regulations?

B., Oldenhof: "The definitions do not completely match with one another. They cover the same material but partner jurisdictions are given the opportunity to interpret matters under local law. I question whether this is a material difference between "investment entity" definition in the FATCA final regulations and the Model 1 and Model 2 IGAs. In my opinion the reason why US Treasury did not literally take the definition "investment entity" from the final regulations and insert it into the IGA is because they provided the opportunity for partner jurisdictions to interpret in a manner consistent with local law as a policy matter."

5 What are in your point of view the biggest industry challenges with respect to the implementation of FATCA?

- **From the IRS perspective**
- **For FFIs and NFFE's**

B., Oldenhof: "From an IRS perspective the biggest challenge is to create a cost-benefit analysis, and to ensure that this new implementing law generates the revenue expected for the IRS and it offsets the costs of implementing. The costs of implementing FATCA and creating the processes needed cost a lot of money, at the end of the day, the question is what the actual benefits are and whether FATCA is even profitable.

From a stakeholder's perspective, the challenge is with respect to US tax cheaters, their chance of getting caught is now 100%. So the challenge is how to deal with the past.

For FFIs the challenge is the time and money FATCA costs to implement. And the regulations do not leave much room for mistakes, in case of noncompliance, you will be subject to 30% withholding tax."

6 What are in your point of view the industry challenges that emerged as a result of the inconsistencies between the final regulations and the IGAs?

B., Oldenhof: "The lack of guidance which includes all the uncertainties that still exist in the IGAs and guidance. Which might result in discussions with the IRS and stakeholders or FFIs regarding the interpretation of certain definitions."

7 The final regulations have been drafted twice in an attempt to make FATCA more comprehensive. Have the challenges in question 6 been addressed after the second set of regulations? If not, what alterations do you think is necessary to address these challenges?

B., Oldenhof: "I'm not certain, I haven't had a chance to go through the draft regulations. The inconsistencies are in a way inevitable. Since FATCA is a US centric regime, giving partner jurisdictions some say was the only way to get them to cooperate and enter into an IGA.

You can distinguish two kinds of inconsistencies, one where a country adopts four categories of FFIs and another country adopts five, this inconsistency is not risky or harmful, the choice of adopting the categories are based on economic motives and policy objectives.

So, for example if the Netherlands opts to include holding companies under the definition of an FFI, it will impact the Netherlands economy negatively because these companies will relocate and as a result people will lose their jobs, and there would be less tax income for the Netherlands.

However the second kind of inconsistency, where a definition has different meanings in other jurisdictions, this type of inconsistency is harmful and risky and such inconsistencies should be removed. What should ultimately happen is that the guidance notes are harmonized and there is one explanatory notes that every jurisdiction can use."

8 What is your view with respect to countries using/relying on other countries guidance notes? Do you see any risk/potential challenges from doing so? Does this contribute to the inconsistencies?

N/A. The interviewer did not have enough time to answer this question. The interviewee had a meeting to attend.

9 In general it is known that the US Treasury and the IRS tried to relief burden for FFIs by cooperating with stakeholders and drafting the final regulations. Do you know if the IRS has a FATCA commission in place to tackle all the challenges that will emerge in the future?

B., Oldenhof: "I agree with a FATCA committee that is something that should eventually happen. I agree with you. To my knowledge there is no FATCA committee and I do not really know why it hasn't already been developed. Obviously, it is ideal to have a committee in place where all the stakeholders are represented. The members of the committee includes members of Treasury, IRS, and FFIs, including US citizens, and there is one coordinated effort towards stopping tax evasion. Such a committee enables collaboration and will further develop the legislation."

10 If not, do you believe that a FATCA committee which would include members of Treasury, IRS, stakeholders from the US and partner jurisdictions, would be able to better address industry challenges faced up to now?

B., Oldenhof: "It is realistic to create a FATCA committee and it seems realistic to get all countries to cooperate, as the OECD Model Convention, where they call on all countries and OECD meetings are held, so I do not see why a FATCA committee isn't feasible. It costs time and money to develop such a regime, and maybe the IRS is arrogant and doesn't want other countries to have more say. But on the other hand, it is necessary to have a practical legislation.

Treasury should have developed one Model and one guidance which includes clear notes and definitions similar to the OECD Model Convention.

However, including such a committee in the IGA and go through the entire negotiation process is very time consuming. Theoretically speaking, it would be ideal to have a central control point, just like the CRS is controlled by OECD and has input from all countries."

Treasury, IRS, nor local governments have adopted deadlines for the implementation of guidance notes. This is generally one of the main issues relating to FATCA. Do you believe that if a synchronized effort were to take place that would push countries to adopt a deadline to publish guidance, this would facilitate the implementation of FATCA?

B., Oldenhof: "The solution towards the inconsistencies would be a uniform guidance notes. I do not agree with the implementation of FATCA. The problems are the result of giving partner jurisdictions so much room for interpretation."

11 If so, do you believe that this is possible by including this in the IGA? The most favored nation clause would allow this potential regulation to apply to every IGA. What are your views on this?

N/A. The interviewer did not have enough time to answer this question. The interviewee had a meeting to attend.

INTERVIEW BRADFORD LABONTE

Tax Law and Economics interview regarding FATCA

Drivers between the inconsistencies between the FATCA final regulations and the IGAs

Date: May 19, 2015

Interviewee: Labonte, Bradford

Interviewer: Guda, Ayoni

Introduction

This Q&A interview provides insight and information into the drivers between the inconsistencies under the FATCA final regulations and the Intergovernmental Agreements ("IGAs") by Bradford Labonte, hereto referred as ("B., Labonte" or "interviewee") an International Tax associate, FATCA expert at KPMG LLP. The person conducting the interview is Ayoni Guda, hereto referred as ("A., Guda" or "interviewer"), an International Tax Intern at KPMG LLP, New York office. The interview will take place at KPMG LLP at 11:30AM Eastern Time, New York office. Notes will be taken throughout the interview, whereas the interviewer will translate these notes into a document.

Interview

1. What are in your views the drivers of the inconsistencies between the FATCA final regulations and the IGAs?

- **With respect to FFI classification**
- **With respect to due diligence and reporting**

B., Labonte: "From a general perspective if you think of how the political process which has led to FATCA has developed which is solely to uncover US account holders and FFIs which were previously undisclosed, so it's more of a political process. It's the outcome of a very heated political process versus the IGAs that arose as that legislative administrative process was ongoing. So to that extent it was more a response of the problems that were being uncovered as the US process was unfolded. So necessarily the IGAs are designed to lighten the burden on FFIs and that's either from a pure administrative or compliance perspective but also in response to local privacy concerns. Any of these inconsistencies would arise in first instance from the fact that the IGAs are meant to ease burden on FFIs in complying with FATCA."

2. Why has US Treasury drafted two Model IGAs and has not taken a uniform approach to these treaties? And do you believe that if the US Treasury adopted only one Model IGA, the implementation of FATCA would have a different outcome, say e.g. like the CRS?

B., Labonte: "You're describing a process that would lead to consistency. I think it's always difficult to ensure consistency across 80/90 jurisdictions but by parallel to the BEPS action, coordinating effort would lead to more efficient tax administration."

My understanding, taking a step back is that a lot of effort towards increasing tax transparency and sharing information kick started by FATCA. To that extent, the US put in a lot of time, money and effort to build up FATCA. I think eventually at the end of the day, I suppose it could be folded into the CRS to some capacity but I'm not too familiar as to how that process is unfolding. Once a process or project has been going down the road for so long it's difficult to switch courses and also it's a very US centric regime. To that extent I would imagine, presumably the US would want these goals to be reflected to some kind of consensus approach."

With respect to the inconsistencies, from a bilateral perspective if I reach an agreement with you, you necessarily can come to different interpretation of that agreement and presumably you need a map type process for competent authorities and that sort of stuff. It's very challenging. This is from a political perspective, the US right now seems to be less lenient than its partner countries.

At the end of the day I think they would get to consistency or down to one guidance and one Model but that would be a decade from now. I'm not too familiar with how the process is unfolding in the US but just in terms of US fulfilling its obligations under the reciprocal IGAs, my understanding is that it's pretty far behind. There are restrictions of sharing information under the reciprocal IGAs from the US perspective, were not gathering the information for which the US is obligated to share with partner jurisdictions. I think it was a year or a year and a half ago, it was basically bank deposit interest, there was some piggy backing on the existing chapter 61 regime on obtaining information from bank deposit interest, but there was some sort of legislative action towards permitting banks to gather and share this information, which is a step towards the information that we need and towards fulfilling reciprocal obligations. The US is far behind holding up their end of the bargain regarding the reciprocal IGAs and were not getting anywhere soon because we have congressional deadlock. And in terms of pushing anything forward and sharing of US taxpayers information with foreign governments there's a major pushback from Rand Paul, they all want to repeal FATCA, though that might not happen it does prevent any further efforts towards the sharing of US taxpayers information.

3. What is the reason that some countries adopted the 5th category of FFIs (holdings and treasury centers) in their FFI classification per the FATCA final regulations and why have some countries adopted just four categories?

B., Labonte: "It can boil down to the terms of interpretation. In that sense if you're just looking at the function, a financial institution and a treasury center would perform certain functions. Or a holding company, if all it does is hold stocks and it doesn't perform any activities and it doesn't have any employees, it's a passive entity. From a general perspective that is within the embed of FATCA but if you want to make a parallel to the PFIC look through rules where stock is not specifically a passive asset depending on your holding percentage, that's a more sophisticated analysis. My guess is that some countries want to paint with the broader brush and look to the functions and what is the institution actually doing. I think you might see treasury center within the definition of a FFI but if all it does is affect intercompany transactions it is carved out of the definition. So to that extent it makes sense because if I have a treasury center in a multinational group, it just basically is there to manage the cash of global enterprise but say it also lends to third parties then it's getting outside of the definition of what a treasury center performs and they might just want to ensure that where an entity that would perform those functions, it actually is a FI and we want it to be subject to those rules. With these rules you can always take two perspectives, one is broad and then carve out or just specifically identify what you're looking at. I think if you're in this category, countries would say there may be instances where these types of entities perform activities which should be subject to the rules but we'll make carve outs pure for intercompany transactions."

4. If the goal of the US Treasury and IRS was to create a uniform approach with respect to the final regulations and the IGAs, why does the term "investment entity" in the IGA differ from that in the final regulations?

B., Labonte: "My guess would be, rather than have to negotiate specific points, you see that there are broad definitions that are subject to interpretation. If you're looking to reach an agreement, you reach an agreement on broad terms and then the details are filled in gradually through interpretations and competent authority. Which is dealt with depending on how the law would develop but I guess part of the idea was you to get people on board and you couldn't full force just say this is the FATCA final regulations and sign here. The inconsistencies are more from a drafting perspective and what people can agree too. You agree to broad points but that is a general feeling. But I'm not exactly sure how the process unfolded."

5. What are in your point of view the biggest industry challenges with respect to the implementation of FATCA?

- From the IRS perspective
- For FFIs and NFFE's

B., Labonte: "One of the challenges is what IRS and Treasury are going to do with all the information once they've received it. In terms of budget, and staff, I don't think they have the necessary means."

6. What are in your point of view the industry challenges that emerged as a result of the inconsistencies between the final regulations and the IGAs?

B., Labonte: "If you're thinking from a literal perspective, you have 80 different regimes to deal with which is just not workable unless you're a very large institution that can afford the cost of FATCA compliance. You have to deal with common standards and general interpretations but the flip side of that is if you're a smaller institution you're not operating in 50-70 countries so the risk to that extent is more theoretical. But it's a lot of work and it costs people a lot of money to get the systems in place and be compliant. And I think the one major challenge is once you have all these different rule sets, addressing these challenges in a coordinated fashion. I think that was one of the issue with the notice of last year that extended the time period and the definition of what a pre-existing account was, that was solely from US perspective and it opened the door for partner jurisdictions to adopt that relief but it was up to partner jurisdictions to adopt that and provide that relief under their own local law and just practically speaking it's very difficult because some countries have other political concerns."

It can be pretty challenging to ensure that relief is provided across all jurisdictions. So keeping up with the applicable rule sets and the status of each country is very challenging.

The other point is for a lot of these FFIs they haven't had to do any of this before other than general AML/KYC compliance. Their obligations are fixed in the IGAs and local laws but the system pivots on the existing US information reporting system that people have not dealt with before. It's a very new concept. Education and outreach and having people understand FATCA. It is a lot of work and people are running a business so there not solely responsible for FATCA compliance and it's just piling on the compliance obligations."

7. The final regulations have been drafted twice in an attempt to make FATCA more comprehensive. Have the challenges in question 6 been addressed after the second set of regulations? If not, what alterations do you think is necessary to address these challenges?

B., Labonte: "I got more heavily involved later in the process so I didn't completely absorb what the proposed regulations were. To the extent I was familiar with them it was more regarding what has changed but solely because I needed to digest so to that extent I'm not really well positioned to speak on how that process unfolded but generally speaking it was the outcome of a lot of industries back and forth and comments and if you view that in parallel with the implementation of the IGA network I think the general idea was to harmonize and to remove the inconsistencies or the more burdensome elements. Generally the regulations as they relate to FFIs they are also relevant as the IGA network was implemented, so the IGAs themselves are doing more of that work than the final regulations. But from a withholding agent perspective I get the sense there was a lot of clarification but the bigger concern was the timeline. Because it takes people a lot of time and effort and money to get their systems in place in order to be able to comply so as the process is unfolding you see things get pushed back."

8. What is your view with respect to countries using/relying on other countries guidance notes? Do you see any risk/potential challenges from doing so? Does this contribute to the inconsistencies?

B., Labonte: "This is a general question as to how to interpret the law, it's a more general issue and when something is extremely vague you will look to supporting authorities to establish a position just because the other country has a sense that it has no source of law for support, which is a reasonable position in the absence of guidance. Practically speaking you don't even have a choice, the IGAs are very vague they don't address a lot of these situations and so you don't really have a choice. The risks are that the relevant country takes a different interpretation but that's always a risk and in the absence of any indication that they would take that position or be less likely to take that position, tax payers have to use their best judgment and act on helpful information that can provide any type of guidance. So it gets back to the challenges of how countries deal with the lack of guidance but in the absence of that you have to take reasonable approaches. To that extent the hope would be that partner jurisdictions would understand these challenges and like the US would afford relief for good faith efforts which you need to comply. The key here is that you're looking to other countries guidance notes so you can make a good faith effort towards compliance. Looking to other authorities' guidance you're making a good faith effort towards compliance."

9. In general it is known that the US Treasury and the IRS tried to relief burden for FFIs by cooperating with stakeholders and drafting the final regulations. Do you know if the IRS has a FATCA commission in place to tackle all the challenges that will emerge in the future?

I think the Washington National Tax people at KPMG have a much clearer picture of what the mechanics of this are. But my understanding of this is that it's just people within Treasury who are responsible for moving this forward. I think there is a competent authority appointed who is responsible for dealing with these IGAs questions but this is parallel to the normal procedure under US tax treaties, where there is a guy in Treasury that is the competent authority and he spearheads the process. So I'm sure someone within Treasury is responsible for this but it's just probably assigned personnel who's just dealing with this.

10. If not, do you believe that a FATCA committee which would include members of Treasury, IRS, stakeholders from the US and partner jurisdictions, would be able to better address industry challenges faced up to now?

B., Labonte: "There are industry associations that deal with these issues and take a position and defend their industry and provide reports to Treasury. From all perspectives the type of problems that a specific commissioner would address, these issues aren't specific to FATCA, these issues can cut across all aspects of US tax administration like if we have a FATCA committee, we should have a emersion committee or 667 committee, or partnership tax committee. There's always these types of push and pull where industries like banking and insurances companies need more specific guidance and to issue regulations that have been promised for 15-20 years. So, I think ideally it would be helpful but they're dealing with so many issues that it will likely be dealt with just like other regulations are dealt with. But to that extent something like that could arise from a reaction from more multilateral efforts to solve these problems and where the US realizes that they need to pour more resources into insuring that our interest are protected in whatever the outcome is of that process. So I think a lot of that is dictated by how transparency initiatives develop on a global level. If it's something that the US needs to do to be more cooperative then more resources might be poured into it.

The sense I'm getting from this conversation is that good faith efforts and efforts towards collaboration are ultimately the most important. You can't put your head in the sand and say we don't want to deal with FATCA lets make it go away. The idea is how can industry collaborate with government and policy makers to best ensure a system is in place and workable while achieving the policy objectives and the

intent of the legislations. I think any kind of avenue that would further that type of collaboration in all respects (whether FATCA and other tax policies) would tend to produce better outcomes.

I guess ultimately understanding the challenges is key but you would need partner jurisdictions on board as well and this has been an issue where industry can be aligned with jurisdictions where the US might have issues and wouldn't care."

11. Treasury, IRS, nor local governments have adopted deadlines for the implementation of guidance notes. This is generally one of the main issues relating to FATCA. Do you believe that if a synchronized effort were to take place that would push countries to adopt a deadline to publish guidance, this would facilitate the implementation of FATCA?

B., Labonte: "There aren't deadlines for implementing guidance notes but there are deadlines for sharing the information with the IRS that's set forth in the IGA. So to that extent from a local country perspective they need to comply with the terms of the IGA but to that extent it's in their interest to make it easier for their local FIs to comply. It's not guidance notes to help the US, its guidance notes for helping partner jurisdictions FIs. Because ultimately if they don't comply and don't implement FATCA and share this information and if the country doesn't live up to the regulations in the IGA those local FIs are deemed non-compliant and subject to US withholding which would hurt their taxes. So I think speaking in terms of incentives to issue guidance notes."

12. If so, do you believe that this is possible by including this in the IGA? The most favored nation clause would allow this potential regulation to apply to every IGA. What are your views on this?

B., Labonte: "Ultimately you will see from the outcomes whether the country is substantially compliant with the IGA and if they're not doing anything that's probably the real issue. But the US negotiated the agreement so that obligation wouldn't exist to all partner jurisdictions that have already entered into IGAs. It's not beneficial for partner jurisdictions government because it's increasing partner jurisdiction compliance burden so it doesn't quite sound to me like implementing in the IGA would be practical."