FATCA
The final stretch before going live

Pascal Noël
Partner
Cross Border Tax-Global
Financial Services Industry
Deloitte

Amandine Horn
Senior Manager
Cross Border Tax-Global
Financial Services Industry
Deloitte

Over the last few years, the trend of global tax transparency and exchange of information has had a considerable impact on the financial industry. With the entry into force of the Foreign Account Tax Compliance Act ('FATCA') withholding tax on 1 July 2014 and the imminent signature of the Luxembourg inter-governmental agreement (IGA), the Luxembourg financial institutions will make a leap towards the world of information exchange. FATCA calls for a completely new mindset to be adopted when doing business and will impact most actors in financial institutions.

The relevant Luxembourg financial institutions will have to comply with the FATCA requirements as implemented into local law. The operational implications should differ slightly depending on the business concerned, as illustrated in the following example.

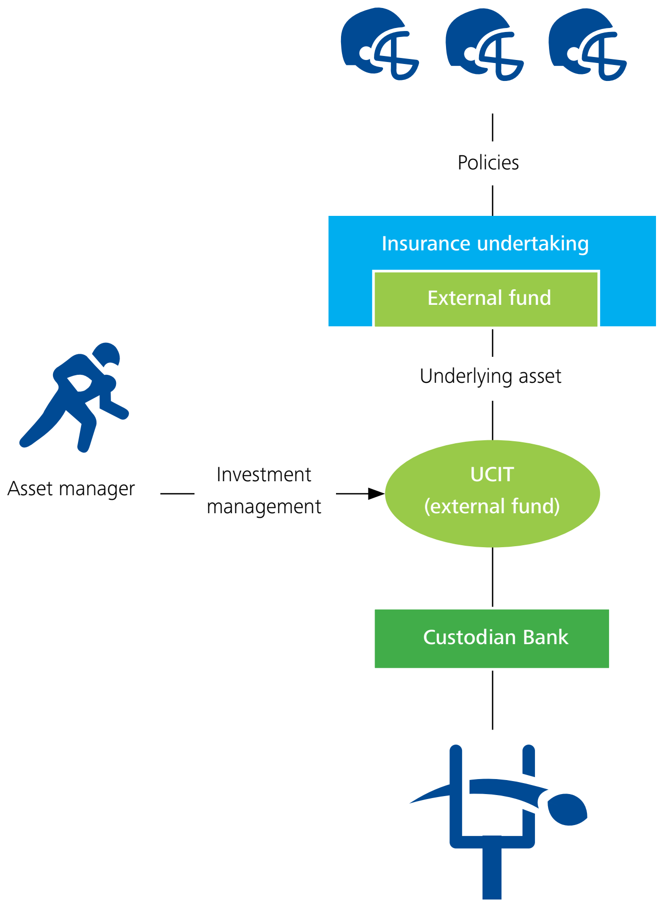
In the example on the right, the insurance undertaking, investment funds, asset manager and custodian bank would be considered as FFIs (Foreign Financial Institutions). The majority of actors within these organisations will participate in the FATCA project.

Risk and compliance teams

The responsibility of registering the entities will most likely fall to the compliance teams, who would also need to implement policies and procedures to enforce the FATCA requirements within the organisation. At a later stage, they will need to provide for internal controls on such FFI requirements.

Registration (depending on the entity's status)

The above-mentioned market players should all be Reporting Model 1 FIs by default (since Luxembourg will sign a Model 1 type IGA implying the automatic exchange of information between the Luxembourg tax authorities and the US tax authorities (IRS)). Nevertheless, the FATCA law as implemented in Luxembourg will grant certain deemed-compliant statuses under conditions (entities subject to less stringent requirements as they present a lower risk of assisting tax evasion). Deemed-compliant status should be limited to remote cases within the banking and insurance industries in Luxembourg.



However, investment funds can choose from several possible deemed-compliant statuses, such as Collective Investment Vehicle status[1]. As these deemed-compliant entities would mainly be Non-Reporting Luxembourg Financial Institutions, they would not need to register.

Consequently, Luxembourg FIs should first be able to determine their status (which must be validated by management) and corresponding registration options. The compliance teams will, where required, register the entity according to its chosen status. They will need to complete and submit their registration, certifying that all information provided during the registration is valid. The person providing the certification can be (but is not necessarily) the Chief Compliance Officer. The sole requirement is that such a person has sufficient authority to enforce the FATCA requirements within the organisation. Nominating a FATCA Responsible Officer, as required under the final regulations, will not be mandatory in Luxembourg (as an IGA Model 1 country), but further guidance in this respect may be brought by the local implementation law.

Implementation of policies and procedures, and internal controls

The FATCA requirements (as detailed below) will need to be properly enforced within the organisation. In this respect, procedures should be implemented in order to formalise the various classification, withholding, reporting and internal control processes resulting from FATCA. Going forward, the detailed due diligence and classification process to be established should indeed be clear and form an integral part of the account opening process.

In the case of non-compliance and material failure in the execution of its obligations, the Reporting FI also runs the risk that the IRS may request a withdrawal of its compliant status, in which case the entity would become a Non-Participating FFI. As a result, the implementation of a compliance programme and internal controls is highly recommended.

Legal department

Luxembourg financial institutions should also consider amending some of their legal documentation, such as General terms and Conditions and contracts (e.g. custody agreements, life insurance policies). These documents should clearly emphasise the financial institutions' obligations under FATCA and their consequences for clients. US clients under the FATCA law will be reported by the financial institution to the Luxembourg tax authorities, who will in turn report the information to the US tax authorities. In the event that clients are non-compliant financial institutions (NPFFIs), Luxembourg financial institutions will also need to levy a withholding tax on payments of US source income and to report the payments made to the Luxembourg tax authorities. These obligations should be made clear to clients in order to avoid any future challenge from clients or commercial issues.

Given the administrative burden that certain client types present, you may also consider how the FATCA status will impact the acceptance of certain individuals or entities as clients: do you intend to continue servicing US clients or NPFFIs?

Front office and client relationship management

FATCA will notably require that an extended due diligence procedure is applied to the financial account holders (as defined by the Law) for all FFIs in order to identify any potential US accounts (individual or entities). As a result, the full involvement of front office teams is necessary to comply with due diligence requirements.

The definition of US accounts is very broad indeed and also relates to US nationals living abroad, green card holders, etc. The notion of financial accounts will obviously differ depending on the business concerned. It ranges from deposit or custodial accounts for banking institutions, to cash value insurance policies for insurance undertakings and even equity and debt holders for investment funds. This due diligence will be required for pre-existing accounts (opened before 1 July 2014) with an extended period in order to facilitate the documentation and identification of such accounts, where required. Due diligence will also apply to any new accounts opened after 1 July 2014 and will necessitate the immediate identification and classification of the accounts.

1 A Collective Investment Vehicle is a regulated Luxembourg investment fund which is held or distributed solely through compliant entities.

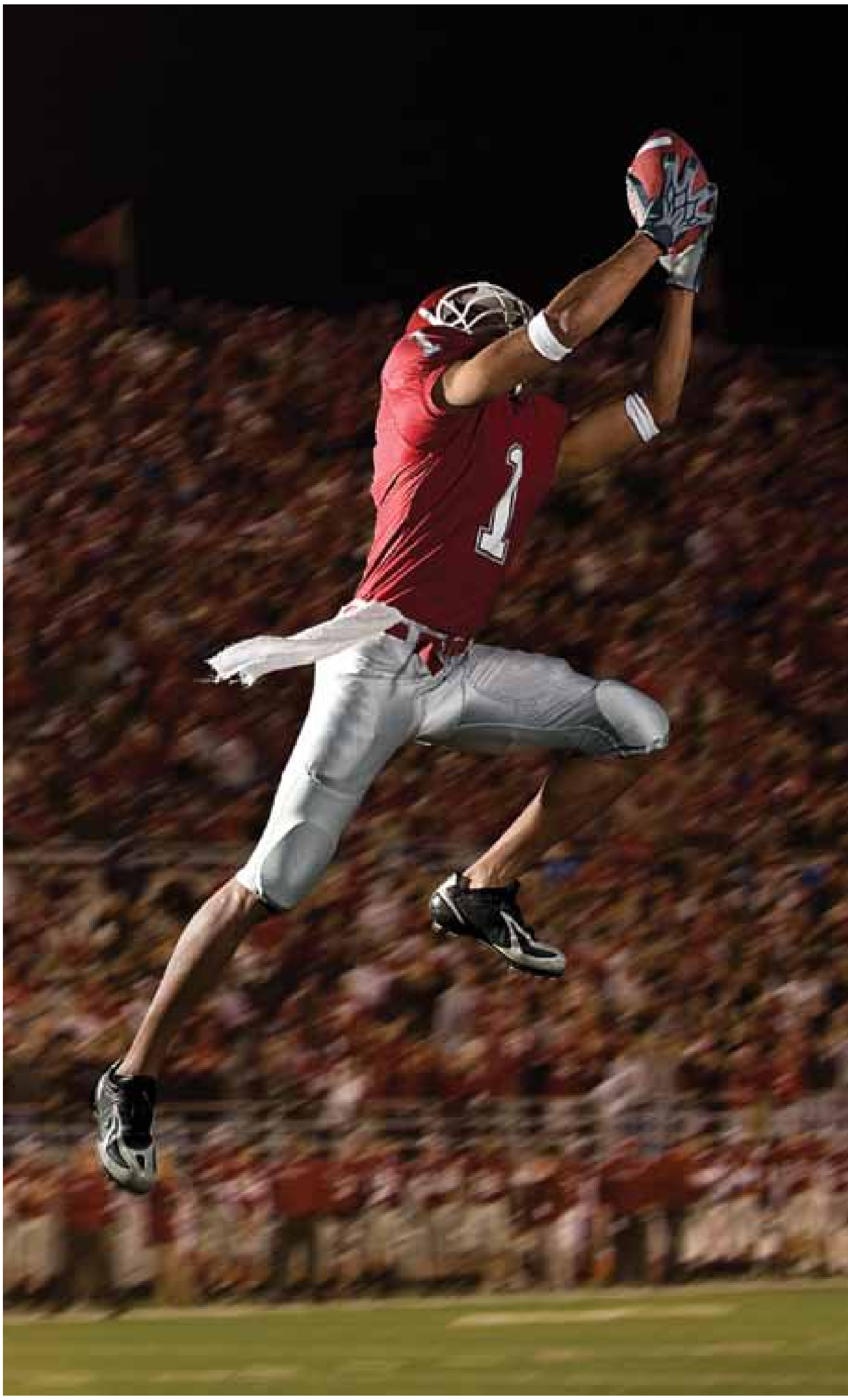
Remediation of existing clients/investors

All Reporting Model 1 FI will review their existing client base in order to search for certain defined US indicia and to classify entities based on FATCA principles. Specific requirements foresee either a search of the entity's electronic database (if the account balance is below the USD 1 million threshold) or a more thorough search of all paper documentation on file for accounts above the threshold. In certain businesses where a relationship manager is appointed to the account (e.g. banking institutions), the relationship manager's knowledge also has to be taken into account. Providing front office teams with thorough training is therefore recommended, as well as documenting when the relationship manager has no 'reason to know' that the information provided to them is incorrect. In case of any US indicia, additional documentation must be requested from the account holder, in which case front office teams will need to play an active role in obtaining such documentation from their existing clients.

External communication plan

In order to inform clients and investors about your new obligations as Reporting Model 1 FIs and request additional documentation from them, you will need to ensure a relevant communication plan is in place. Luxembourg financial institutions will also have to implement processes to manage potential questions from clients in this regard and collect and follow up documentation.

The relevant Luxembourg financial institutions will have to comply with the FATCA requirements as implemented into local law



Clients and various other counterparties will also need to be informed of the new processes and requirements. Clients' and counterparties' jurisdictions should be taken into account when drawing up the communication plan. Indeed, reporting and withholding obligations apply for non-participating FFIs clients and should affect FFIs established in non-IGA countries and countries which have not signed an FFI agreement. Similarly, entities having certain deemed-compliant statuses in non-IGA countries will have a GIIN to provide to the Luxembourg financial institutions (because they will be registered). Conversely, entities having the same status within an IGA Model 1 country will not necessarily have a GIIN number (they may not need to register depending on the country's requirements). As a result, cross-border situations will bring an additional complexity in the application of the FATCA provisions.

In the case of the example above, the custodian bank should obtain self-certification from the investment fund in order to document its FATCA status. Within the investment management industry, this due diligence on pre-existing accounts also initially calls for assistance from certain investment funds' service providers, such as management companies or transfer agents. For insurance undertakings, this step requires either the policyholder or the beneficiary of an insurance policy to be nominated as an account holder: who will be entitled to access the amount foreseen by the contract or change a beneficiary under the contract? If the policyholder is a non-US individual who has a US address, the account will show the presence of US indicia. The insurance undertaking will have to ensure a self-certification form is collected from the account holder confirming its non-US status.

Modification of client acceptance procedures

Regarding new accounts, these indicia will need to be verified when accounts are opened. Indeed, Reporting Model 1 FFIs will need to evidence their due diligence in order to anticipate potential future audits by the Luxembourg tax authorities. In this respect, Luxembourg financial institutions should enquire, inter alia, about an individual's US place of birth, a possible dual nationality, US address or power of attorney granted to a person with a US address, etc. Luxembourg financial institutions will also need to obtain a self-certification of an entity's FATCA status (either as participating FFI, deemed-compliant FFI or non-participating FFI). This self-certification may be replaced by the traditional official US forms (in English language only) to be completed by the clients depending on their status for US tax purposes: W-8BEN, W-8IMY or W-9 forms.

IT infrastructure and development

Luxembourg financial institutions should consider how to store all the additional documentation that will be needed further to the implementation of FATCA. Indeed, US indicia and new data storage should be considered for documentation/know your customer tools. Current systems will need to be updated, either through internal development or releases provided by your IT service provider.

Luxembourg financial institutions will also need to assess the extent of the reporting they will be required to file, in order to address the need for reporting solutions. The same assessment should also be made for the withholding tax that they would need to compute. Nevertheless, only certain FFIs (mainly banking institutions already having the primary US withholding responsibility under a QI agreement) will actually need to levy the withholding tax themselves. All other FFIs will provide their upstream custodian with withholding statements indicating the prorata of withholding tax to be levied on certain accounts/amounts. Reporting and withholding (including withholding statement issuance) processes and solutions will need to be defined in order to avoid manual processing. Reporting solutions and data format may be imposed by the Luxembourg tax authorities in the future.

Tax and finance departments

As indicated, the Reporting FIs will have to apply the FATCA withholding tax in certain cases: where an FFI that was also a QI already had US withholding tax responsibility in the past, it would also need to levy FATCA withholding tax on US source payments made to Non-Participating FFI clients as of 1 July 2014. Non-Participating FFIs would be entities located in a non-IGA country that have not entered into an FFI agreement with the IRS. Entities located in IGA countries would only become Non-Participating FFIs in the event of material failure in the execution of their obligations and after the end of a certain period provided for by the Law.

In practice, in Luxembourg (an IGA Model 1 country), only QIs having assumed primary withholding responsibility or partnership acting as withholding foreign partnerships would actually withhold the taxes. Once the situations/accounts on which withholding tax is due have been determined, the back office teams (trade execution, securities department) would need to ensure that such withholding tax is indeed levied on the payment. If the FFI does not have the responsibility to withhold the tax itself, it then needs to issue withholding statements for the sub-custodians.

The tax department would need to provide reporting on the US accounts to the Luxembourg tax authorities. Within an investment fund context, the reporting may lead to additional complexity depending on whether the fund registers at umbrella or sub-fund level (for reporting purposes, the investments would need to either be aggregated or not depending on such choice).

The responsibility of registering the entities will most likely fall to the compliance teams, who would also need to implement policies and procedures to enforce the FATCA requirements within the organisation

The article was written in early February 2014 and does not take into account the last updates regarding FATCA. On Thursday, February 20, 2014, the U.S. Department of Treasury ('Treasury') and the Internal Revenue Service ('IRS') released **final and temporary regulations('Temporary Regulations')** that revise and clarify FATCA regulations. The Treasury and IRS also released temporary regulations coordinating the final regulations under Chapters 3 and 61 of the Internal Revenue Code ('Code') with the final FATCA (Chapter 4) regulations **('Coordination Regulations').**

More information on http://www.deloitte.com/lu/otn/fatca050314