

FATCA: Coming Soon to a Broker Near You

November 8, 2012



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Today's Objectives

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Objectives

Understand why FATCA was enacted and is not going away

Clarify where we are today

Understand high level process requirements

- Account opening
- Account remediation
- Reporting to government
- Timeline for implementation
- Key issues for the industry and the need to work together for a practical solution

FATCA & the Five Stages of Grief

You've got to be kidding- right?

Who do "they" think they are?

Maybe it will go away.

Woe is me!

OK, what do we/I have to do?

FATCA Overview

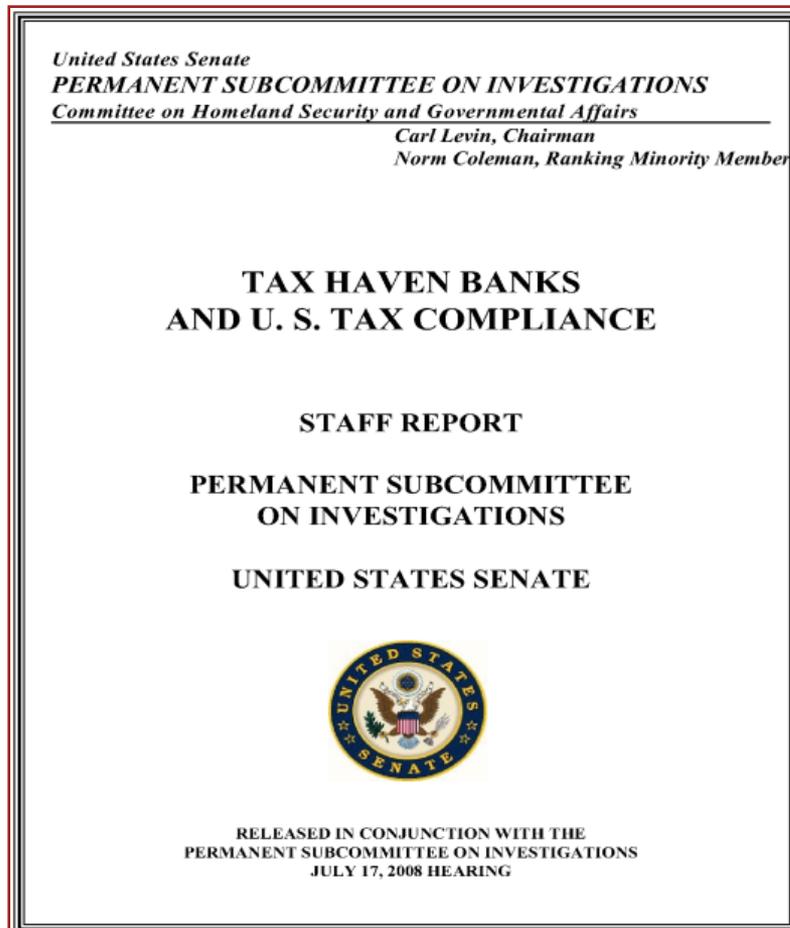
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Background - Congressional Action

Tax haven banks and US tax compliance

Issue:

- US persons are using foreign entities to invest and avoid US reporting and back-up withholding.
- US persons are certifying to be foreign persons.
- US persons are availing themselves of treaty benefits.
- The US loses an estimated \$100 billion in tax revenues annually due to offshore tax abuses.
- Financial institutions may be facilitating offshore tax evasion
- The amount of offshore capital was increasing



FATCA's Origin - One plank in the platform of increased U.S. tax reporting & withholding



Specific Issues Addressed

- Foreign Financial Institutions (“FFI”) were used to shield U.S. taxpayers identity from the IRS
- Foreign banking privacy laws in certain tax havens were difficult to overcome and became a practical impediment to detecting tax evasion

Response

- The Foreign Account Tax Compliance Act (FATCA) provisions were included in the Hiring Incentives to Restore Employment (HIRE) Act passed in March 2010 in the US
- New withholding and reporting regime was created to provide the Internal Revenue Service (“IRS”) with additional tools which:
 - Require Foreign Financial Institutions (“FFI”) to perform a more exhaustive search for U.S. persons; and
 - Require Non Financial Foreign Entities (“NFFE”) to disclose substantial U.S. Owners
 - Withholding of 30% on actual or deemed US source payments and gross proceeds from the sale of US debt/equities

FATCA- where are we today?

- **FATCA has already been enacted as US legislation**
 - Regulations are in draft and are expected to be re-released by year end
 - Application date is January 1, 2014 for some elements, others phased in throughout 2014- 2017
- **Recognizing international constraints on privacy and account closures, an alternative approach to implementation was recently released:**
 - A model Intergovernmental Agreement (IGA) to allow information to be provided to local government followed by gov't to gov't exchange
 - Bilateral negotiations to take into account country specifics
 - Over 40 countries currently negotiating this approach, 1 completed recently by UK
 - Canada is negotiating bilateral IGA, widely expected to be signed Fall 2012.

Will FATCA go away if Canada has an IGA?

- **No, it will not go away because:**
 - **Once a Canada/US IGA is signed:**
 - Canadian tax legislation, regulations will be changed to require due diligence on existing accounts, new account opening procedures and reporting by all “Reporting Financial Institutions” unless they are specifically listed as exempt or unless they meet criteria to be “deemed compliant”
 - Brokers, Investment Advisors will be Reporting Financial Institutions unless they meet the criteria to be “deemed compliant”
 - Compliance will be a domestic requirement with expected penalties for non-compliance
 - IRS will be able to direct some queries to Canadian companies regarding the information they submit to the Canadian government.
 - Non-compliance may result in blacklisting the entity so that FATCA withholding is levied on payments to the entity.
 - **Entities interact with other financial institutions domestically and internationally who will be affected by FATCA or IGA’s**

FATCA Current State- 2 distinct tracks

FATCA Legislation

- Legislation passed
- Regulations proposed
- Comment letters made by industry
- Some draft forms issued
- Agreement for FFI's not yet released
- Regulations will need to be revised
- Implementation January 1, 2014

Intergovernmental Agreement

- Draft model agreement released
- Primarily deals with privacy issues
- Dept of Finance is negotiating with US Treasury for gov't to gov't exchange of info
- Needs Parliamentary process but expected to pass next year
- Industry lobbying is ongoing
- Implementation Jan 1, 2014

FATCA OR IGA- which one applies?

- **To have an IGA govern by Dec 31, 2013, the following must occur:**
 - Negotiation of bilateral IGA and signature (ongoing- expect FALL 2012)
 - Enact Income Tax Amendments- expect 2013
 - Enact Tax Regulations- expect 2013
 - Exchange letters with US confirming all domestic requirements to have IGA implemented are complete- expect 2013
- **If this doesn't happen:**
 - US FATCA legislation applies January 1, 2014 based on the most recent notice issued on October 24, 2012 for entities that are Participating FFIs and enter into an IRS agreement prior to that time.
 - Entities having Financial Accounts will need to become “Participating FFIs” (“PFFIs”) to avoid withholding on US source income and gross proceeds from the sale of US debt/equity.
 - IRS recognizes some countries will sign IGA but not be ready by Jan 1, 2014

“PFFI” – Participating FFI so what does it mean under FATCA?

To be participating the FFI must:

- Enter an agreement (the “FFI Agreement”) with the IRS to comply with certain requirements
- Under the agreement, a PFFI will be required to:
 - Amend account opening procedures to identify such persons
 - Review existing/obtain new information on certain existing account holders to determine which accounts are US accounts, recalcitrants or non-participating FFIs
 - Comply with required due diligence/verification procedures and certify completion of such procedures
 - Attempt to obtain a waiver of applicable privacy legislation or close the US account
 - Comply with IRS information requests
 - Report information on US accountholders and other information
 - Deduct and withhold a 30% tax on any “passthru payment” to recalcitrant account holders or non-participating FFIs (this element delayed until no earlier than January 1, 2017)

In Return

- Avoids 30% on payments of US source income (beginning January 1, 2014) and gross proceeds from sale of US debt and equity (beginning January 1, 2017)

“Reporting Financial Institution” so what does it mean under an IGA?

Unless Exempted, Reporting Financial Institutions must:

- Provide information to their local government to comply with local law that supports the IGA entered into between their local government and the US.

- Obligations**
- Amend account opening procedures to identify Reportable Accounts
 - Review existing/obtain new information on certain existing account holders to determine which accounts are Reportable Accounts or accounts of non-participating FFIs
 - Comply with required due diligence/verification procedures
 - Comply with IRS information requests
 - Report information on US accountholders and other information
 - Likely require registration with US but details not known

In Return

- Benefits**
- Avoids 30% on payments of US source income and gross proceeds from sale of US debt and equity
 - Usually eliminates the need for withholding, but requires information to be provided regarding payments to certain payees
 - Does not require closing accounts
 - May not require passthru or gross proceeds withholding (future negotiations)

How the FATCA and IGA Frameworks Differ

Issue	FATCA	IGA
Agreement with IRS required	Yes	No, some form of registration likely required to obtain a tax ID number
Due diligence on existing and new account base required	Yes	Yes- slight differences
Reporting on affected accounts	To the IRS	To the local government for exchange with US
Governing law	US	Local law, but with references to the FATCA regulations likely
Account closures	Required for recalcitrants	Not required but reporting required
Withholding	Required for recalcitrants and non-participating FFIs	Withholding eliminated except for certain withholding agents but reporting is required to allow others to withhold
Certification by officer	Required	Silent

***Who is in Scope and
What is in Scope?***

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Financial Institutions in the FATCA Regime- who is affected?

Activity:

Examples:

- Accepts deposits in the ordinary course of a banking or similar business (Type 1)

- Savings bank,
- Commercial bank,
- Loan Associations
- Thrifts

- Credit unions
- Co-operative banking institutions

OR

- As a substantial portion of its business, holds financial assets for the account of others
- 3 year 20% gross revenue test (Type 2)

- **Broker Dealers**
- **Clearing Organizations**
- Trust Companies

- **Custodial banks**
- Custodian of Employee Benefit Plan

OR

- Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities, or any interest in such assets (including derivatives such as forwards, futures or options)
- 3 year 50% gross revenue test (Type 3)

- Mutual Funds
- Funds of Funds
- ETF
- Hedge Funds
- Private Equity Funds
- Venture Capital Funds
- Sovereign Wealth Funds

- Commodity Pools
- Managed Funds
- Collective Investment Vehicles

OR

- Is an insurance company (or holding company of an insurance company) obligated to make payments with respect to cash value insurance contracts and annuity contracts (Type 4)

- Life, Reinsurance



Additional entities affected by the IGA Framework

Entities that conduct as a business for customers **any** of:

- Trading in transferable securities, foreign exchange, money market instruments, derivatives, futures, index instruments
 - Individual or collective portfolio management
 - Investing , administering or managing funds or money on behalf of other persons
-
- **A Canadian IGA is expected to broaden the scope of persons who will be required to assume FATCA responsibilities to the Canadian government. Introducing Brokers and Investment Advisors will be Reporting Financial Institutions unless they are “deemed compliant”.**

Who is in Scope under an IGA?

Financial Institution (FI) – any Depository Institution, Custodial Institution, Investment Entity or Specified Insurance Company

Activity:

Examples:

- Accepts deposits in the ordinary course of a banking or similar business
(Depository Institution)

- Savings bank,
- Commercial bank,
- Loan Associations
- Thrifts

- Credit unions
- Co-operative banking institutions

OR

- As a substantial portion of its business, holds financial assets for the account of others
- 3 year 20% gross revenue test
(Custodial Institution)

- Broker Dealers
- Clearing Organizations
- Trust Companies

- Custodial banks
- Custodian of Employee Benefit Plan

OR

- 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 a customer:
- trading in money market instruments, derivatives, FX, interest rate or index instruments, transferable securities or commodity futures
- Individual or collective portfolio management
- Otherwise investing, administering or managing funds or money on behalf of other persons
- The interpretation of this to be consistent with FATF's definition of financial institution.
(Investment Entity)

- Mutual Funds
- Funds of Funds
- ETF
- Hedge Funds
- Private Equity Funds
- Venture Capital Funds
- Sovereign Wealth Funds

- Commodity Pools
- Managed Funds
- Collective Investment Vehicles
- **Fund Managers**
- **Investment Advisors**

OR

- Is an insurance company (or holding company of an insurance company) obligated to make payments with respect to cash value insurance contracts and annuity contracts
(Specified Insurance Company)

- Life, P&C, Reinsurance

Participation is “voluntary” under FATCA but not under the IGA

Clearing brokers will need to be FATCA compliant

Why ?

1. A Qualified Intermediary that has assumed primary withholding responsibility and will be required assume FATCA responsibilities.
2. US source income/gross proceeds will be subject to withholding under FATCA. Questions remain around foreign passthru payments under both FATCA and the IGAs as well as the treatment of gross proceeds under IGAs.
3. Brokers will need to be compliant to avoid withholding on payments as refunds for customers will be cumbersome to obtain and foreign tax credit claims will be limited.
4. Clearing Brokers may need to rely on other service providers.
5. Regulations may not be prescriptive- requiring industry solution.

Deemed Compliant FFIs- not a panacea – but some Introducers may benefit

- Must be licensed and regulated as securities broker or dealer
- No fixed place of business outside Canada
- No solicitation of customers outside of Canada
- If in an expanded affiliated group, each member must qualify
- Must be required to perform information reporting on accounts
- Some differences exist between the rest of the proposed criteria for FATCA regulations and the IGA agreement signed between the UK and the US:
 - If Canada follows the UK agreement, will need to examine nuanced differences and assess business impacts

FATCA Processes under the IGA

Document Clients

- The documentation process applies to pre-existing and new **“financial accounts”**
- Objective is to identify US Reportable Accounts - those owned by Specified US persons and non-US entities with “controlling persons” who are specified US persons
- Also need to identify Non-Participating FFIs

Reporting

- Report annually on the US Reportable Accounts and recalcitrant accounts to government
- Report to the accountholders might be required
- Report on payments made to non-participating FFIs

Withholding

- Withholding only required if the payer is a QI making a payment to a non-participating FFI
- Information to be provided by other intermediaries receiving payments for non-participating FFIs to allow US Withholding Agents to withhold

Financial Accounts- What are they?

Financial Accounts include:

- Depository Accounts
- Custodial Accounts
- Debt/Equity not publicly traded
- Certain insurance products with cash value
- Annuities

US Reportable Accounts- what are they?

Specified US Persons

- US citizens regardless of where living
- US greencard holders
- Persons living in the US
- Snowbirds
- US corporations, other than those regularly traded and those more than 50% owned by such companies
- US Partnerships
- A trust if a US Court has authority over administration and one or more US persons have authority to control all substantial decisions of the trust
- An estate where the decedent was a US citizen or resident in the US
- Other exclusions

Non-US Entity with Controlling Persons that are Specified US Persons

- Controlling persons are natural persons who exercised control over the entity
- For Trusts - includes settlor, trustee, protector, beneficiaries and any other individual exercising ultimate control
- For arrangements other than trust it is the person who exercises ultimate control
- Control is determined in accordance with the FATF Recommendations
- Canada has not yet adopted FATF Recommendations
- Is it 25 % or 10% threshold?

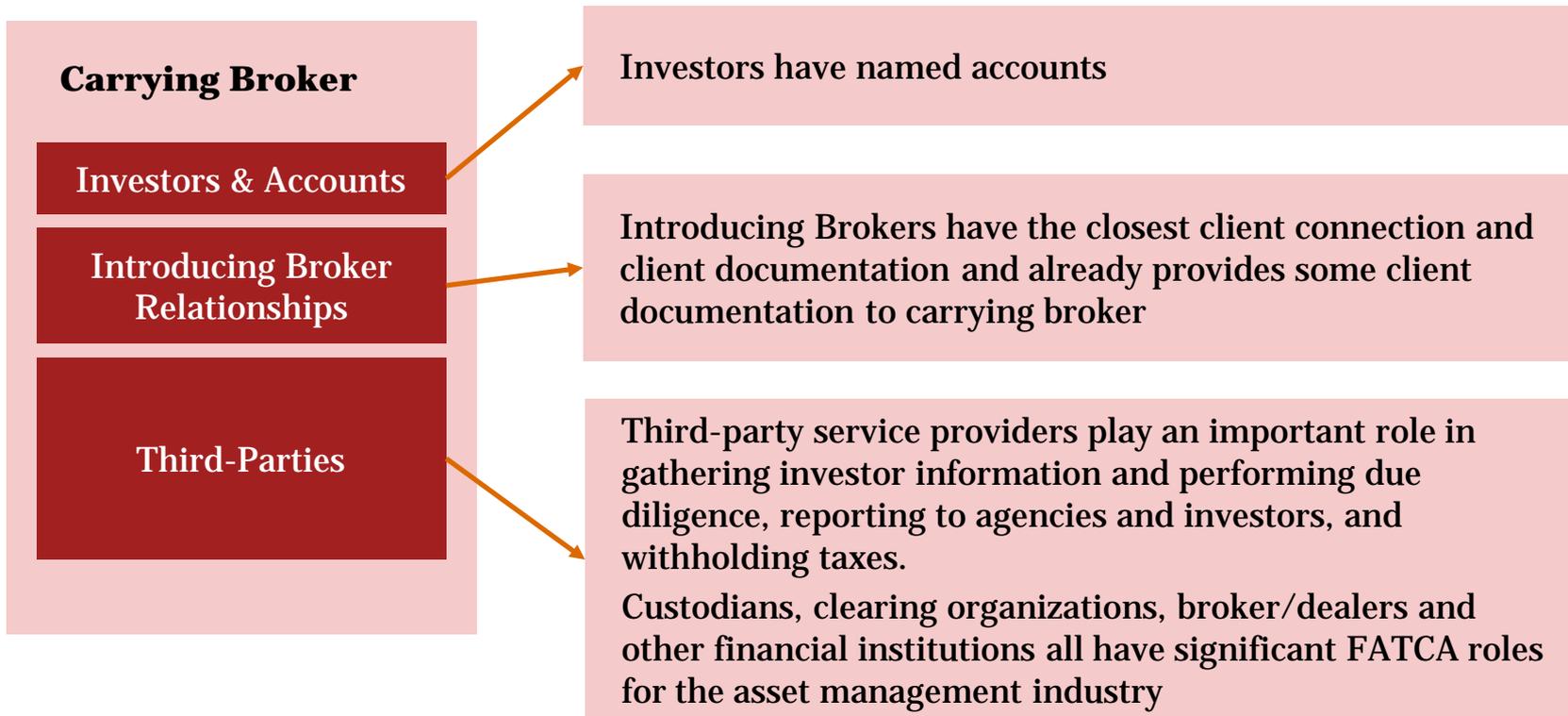
Key Aspects of the IGA Regime – what are you looking for? Due Diligence– Searches for Indicia of Potential US Status

Indicia	Required Documentation
a) US citizenship or lawful US resident (e.g.. green card holder)	<ul style="list-style-type: none"> • Treat as a reportable account
b) Unambiguous indication of US place of birth	<ul style="list-style-type: none"> • Obtain or have previously reviewed and maintains a record of : • Self certification of non-US citizenship or resident (W8 or agreed form) and <ul style="list-style-type: none"> • Non US passport or similar government–issued document establishing client’s citizenship in a country other than US and • Reasonable explanation regarding client’s renunciation of US citizenship or reason why client did not acquire US citizenship at birth (if applicable),or certificate of loss nationality or Form I-407
c) Current US Residence address or US mailing address (including a US post office box or US “in care of address) or one or more US telephone numbers that are the only phone numbers associated with the account	<ul style="list-style-type: none"> • Obtains or have previously reviewed and maintains a record of: • Self certification that the account holder is not a US citizen or resident (W8 or agreed form) and • A non-US passport or other government issued identification evidencing citizenship in another country
d) Standing instructions to transfer funds to an account maintained in the US	<ul style="list-style-type: none"> • Obtain or have previously reviewed and maintains a record of: • Self certification that the person is not a US citizen or resident (W8 or agreed form) and • Documentary evidence as defined in the specified list in the Annex
e) Both a US and non-US telephone number associated with the account	<ul style="list-style-type: none"> • Obtains or has previously reviewed and maintains a record of: • Self certification that the person is not a US citizen or resident (W8 or agreed form) or • Documentary evidence establishing the account holder’s non-US status
f) Currently effective power of attorney or signatory authority granted to a person with a US address	
g) An “in-care-of” or “hold mail” address that is the sole address on file. For pre-existing individual low value accounts, an in-care of address outside the US is not an US indicia	

***Issues specific to
Introducing and
Carrying Brokers***

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FATCA Impact on Introducing and Carrying brokers



A 3 dimensional relationship in a 2 dimensional FATCA regime

FATCA requires the FFI maintaining a financial account to apply the requisite due diligence procedures. Problem is:

- CB is a withholding agent liable for failure to withhold and is required to document each account
- Introducing broker has the primary AML responsibility/ client documentation due to regulatory requirements
- CB has very limited client account details and is reliant on IB
- IB is not an agent of CB in the collection of information
- IB acts as agent for the client
- The rule that allows brokers to rely on a certification from another broker that it holds a valid beneficial ownership statement is deficient because it only applies to US brokers

Who maintains the financial account?

Critical aspect for FATCA because

- FFIs maintaining financial accounts have central role in FATCA compliance regime
- Financial account includes a “custodial account”
 - Custodial account means account for the benefit of another person that **holds** financial instruments
- Account holder is the person identified as the holder of the account by the person who maintains it
- An industry solution is required to deal with introducers/distributors to allow efficient reporting

Timelines under FATCA and an IGA

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FATCA timeline for PFFIs in non-IGA countries

(For FFI agreements effective on January 1, 2014)

	2012	2013	2014	2015	2016	2017 / 2018
FFI Governance		<ul style="list-style-type: none"> Jan 1 2013 – Earliest date an FFI can either register or apply for FFI Agreement online (Note 1) 	<ul style="list-style-type: none"> Jan 1 2014 – Earliest effective date of an FFI Agreement 	<ul style="list-style-type: none"> Jan 1 2015 – Responsible officer must be able to certify completion of identification and review of preexisting high value individual accounts (Note 2) 	<ul style="list-style-type: none"> Jan 1 2016 – Responsible officer must be able to certify completion of identification and review for preexisting individual and entity accounts (Note 3) Jan 1 2016 – Expanded affiliated group transition period ends for Limited FFIs and Limited Branches 	
Due diligence for preexisting accounts			<ul style="list-style-type: none"> Jun 30 2014 – Complete identification and review of preexisting entity account holders that are prima facie FFIs 	<ul style="list-style-type: none"> Dec 31 2014 – Complete identification and review of preexisting high value individual accounts 	<ul style="list-style-type: none"> Dec 31 2015 – Complete identification and review of all remaining preexisting individual and entity accounts (Note 3) 	
Procedures for new accounts			<ul style="list-style-type: none"> Jan 1 2014 – Enhanced account opening procedures must be in place to establish the FATCA status of new accounts (Note 3) 			
Withholding	<ul style="list-style-type: none"> Jan 1 2013 – Cut-off date for grandfathered obligations (Note 4) 		<ul style="list-style-type: none"> Jan 1 2014 – Begin FATCA withholding on US source FDAP income July 1 2014 – Begin FATCA withholding on preexisting entity account holders that are undocumented prima facie FFIs 	<ul style="list-style-type: none"> January 1 2015 – Begin FATCA withholding on any undocumented individual preexisting high value account 	<ul style="list-style-type: none"> January 1 2016 – Begin FATCA withholding on remaining undocumented preexisting accounts 	<ul style="list-style-type: none"> Jan 1 2017 – Begin FATCA withholding on gross proceeds. FATCA withholding is also expected to begin for foreign passthrough payments.
Reporting				<ul style="list-style-type: none"> Mar 15 2015 – Begin FATCA reporting on Form 1042-S for U.S. source FDAP income for calendar year 2014 March 31 2015 – Limited FATCA reporting for calendar year 2013 & 2014 for US accounts (Note 5) March 31 2015 – Begin aggregate FATCA reporting for recalcitrant accounts 	<ul style="list-style-type: none"> March 15 2016 – FATCA reporting must include foreign reportable amounts paid to NPFIs during calendar year 2015 (also applies to calendar year 2016) March 31 2016 – Limited FATCA reporting on U.S. accounts for calendar year 2015 includes certain payments made with respect to the account 	<ul style="list-style-type: none"> March 31 2017 – Full FATCA reporting on U.S. accounts begins for calendar year 2016 March 15 2018 – Begin FATCA reporting on Form 1042-S for U.S. gross proceeds and potentially foreign passthrough payments for calendar year 2017

(1) This date is subject to change as it was not specifically mentioned in IRS Announcement 2012-42.

(2) As part of the first certification, FFI must also certify that it did not have any procedures in place from August 6, 2011 that would assist account holders in the avoidance of FATCA.

(3) Certain de minimis thresholds and retesting rules may apply.

(4) The final regulations are expected to modify the concept of grandfathered obligations to include the following categories: (1) any obligation that produces or could produce a foreign passthrough payment and cannot produce a withholdable payment, provided the obligation is outstanding six months after the date that final regulations defining the term 'foreign passthrough payment' are issued; (2) any instrument that gives rise to a withholdable payment solely because the instrument is treated as giving rise to a dividend equivalent payment under section 871(m) of the Code, providing the instrument is outstanding six months after the effective date of that provision; and (3) any obligation to make a payment with respect to, or to repay, collateral posted to secure obligations under a notional principal contract that is itself a grandfathered obligation.

(5) Limited reporting includes name, address, TIN, account number, and account balance of each specified US person who is an account holder. For account holders that are NFFEs that are US owned foreign entities, report name, address and TIN (if any) of such entity and each substantial US owner of such entity.

FATCA timeline for FFIs under Model I IGAs (Note 1)

	2012	2013	2014	2015	2016	2017 / 2018
FFI governance		◆ Jan 1 2013 – Earliest date that an FFI can register for an FFI EIN (Note 2)	◆ Jan 1 2014 – Earliest date that an FFI can be a Partner Country FI			
Due diligence for preexisting accounts				◆ Dec 31 2014 – Complete identification and review of preexisting high value individual accounts (Note 3)	◆ Dec 31 2015 – Complete identification and review of all remaining preexisting accounts (Note 3)	
Procedures for new accounts			◆ Jan 1 2014 – Enhanced account opening procedures must be in place to establish the FATCA status of new accounts (Note 3)			
Withholding (See Note 5)			◆ Jan 1 2014 – Begin FATCA withholding on US source FDAP to NPFIs (Note 4)			
Reporting				Prior to Sep 30, 2015 – Reporting FATCA Partner FI will need to provide required information to FATCA Partner prior to IGA deadlines in order for FATCA Partner to be able to meet corresponding deadlines (Note 6)	2016 – Reporting FATCA Partner FI to report to FATCA Partner Country the name and the aggregate amount of payments made in 2015 and 2016 to NPFI (Note 6)	2017 – Reporting FATCA Partner FI to obtain and report TIN of each specified US account holder for preexisting accounts (Note 6)

(1) IGA: Intergovernmental Agreement

(2) This date is subject to change as it was not specifically mentioned in IRS Announcement 2012-42.

(3) Certain de minimis thresholds and retesting rules may apply.

(4) Withholding applies to US source income paid to nonparticipating financial institutions by reporting FATCA Partner financial institutions acting as a withholding QI, withholding foreign partnership or withholding foreign trust. Other reporting FATCA Partner financial institutions must either withhold or provide information necessary to allow its immediate payer to withhold.

(5) Dates for withholding on gross proceeds and passthru payments are highly speculative and will be worked out between the US and FATCA partner countries in the next two years.

(6) Dates will be provided under legislation or regulations issued by FATCA Partner tax authorities.

Recap

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What we know

- FATCA will not go away
- Canada is in the process of negotiating an IGA
- Either FATCA or an IGA have implementation date of Jan 1, 2014
- Changes will involve
 - Account opening procedures
 - Account remediation
 - Reporting
 - Withholding (for some)
- Systems changes will be required
- There are still unknowns but no reason to delay

Thank You