Final Guidance Notes on the administration of the US-UK Intergovernmental Agreement (IGA) issued by HMRC

On 31 May 2013 HMRC published final Guidance Notes to the Implementation of the International Tax Compliance (United States of America) Regulations 2013 (“the Guidance”). An updated draft of the Regulations was also published.

Whilst the Regulations themselves are still in draft form and expected to be finalised later this summer, the updated Guidance provides welcome clarity for businesses preparing to be ready to comply with FATCA from 1 January 2014.

This is the first guidance issued by a government that has entered into an IGA with the US and is required reading for anyone involved (or soon to be involved) in an IGA (or FATCA) compliance programme.

Background

FATCA is part of the US law aimed at reducing tax evasion by US persons. It does this by requiring Financial Institutions worldwide to report information about their US customers to the IRS. Financial Institutions that do not agree to do this may suffer 30% withholding tax on certain US sourced income.

On 12 September 2012, the UK and US signed a Treaty (the IGA) to implement FATCA in the UK. From a UK point of view, this treaty was intended to reduce the legal and practical challenges for UK financial institutions of complying with FATCA.

HMRC undertook a period of consultation on how best to implement the treaty and issued draft Guidance Notes in December. On 17 January the IRS issued final FATCA Regulations which ran to more than 500 pages and provided much sought after clarity on how the US law should be implemented.

The final HMRC Guidance we now have before us incorporates many of the changes contained in the Final FATCA Regulations as well as the results of the consultation process.
At just under 150 pages, the Guidance does contain a lot of detail but it is none the less a clear and pragmatic interpretation of the IGA principles which should form a good platform for Financial Institutions to prepare to comply with FATCA by 1 January 2014.

As such, the Guidance should be warmly welcomed, not least because this is the first IGA guidance to be published by any tax authority and we believe will set a practical benchmark for other countries’ implementation standards as they seek to draft their own guidance.

This Alert highlights some of the key developments contained in the guidance:

- Clarification of the definition of Investment Entity
- The treatment of trusts and the status of the trust versus the trustee
- The introduction of registered and certified deemed compliance
- Clarification around the treatment of Annuities and Deceased accounts
- The ability to elect out of the application of threshold exemptions

Scope

The Guidance follows the logic of the questions that FATCA requires Financial Institutions to ask, which is: Am I Financial Institution? Do I hold Financial Accounts? Are the holders of those accounts US persons? And do I have to report them? The Guidance also deals with compliance and registration.

Financial Institutions

The definition of Financial Institution has been expanded to now also include Holding Companies and Treasury Centres of Financial Groups, so as to align the definition with that contained in the US Treasury regulations.

Therefore, under both the US Treasury regulations and the UK regulations, the definition of Financial Institution consists of: depository institutions, custodial institutions, investment entities, specified insurance companies, and holding companies and treasury centres of financial groups.

As explained in more detail below, the Guidance provides greater clarity with respect to when an entity will fit into one of these categories, especially with respect to the treatment of investment entities and trusts.

Investment entities

The Guidance clarifies a number of points concerning investment entities that were unclear up until now. In particular:

- When an entity is “managed”: where an entity has gross income that is primarily attributable to investing, reinvesting, or trading in financial assets and is managed by a financial institution that performs any of those activities, either directly or through another third party service provider, the managed entity will be determined to be an investment entity.
- This clarifies that in order to be “managed”, the managing entity must perform more than just administrative functions (e.g., sending out customer statements).
- Entities managed by individuals: an entity managed by an individual is not an investment entity.
- Investment entities holding real property interests: an entity whose assets consist of non-debt direct interests in real property, even if managed by another investment entity, will not be an investment entity.

Trusts

The Guidance contains the long-awaited guidance as to how trusts will be treated for FATCA purposes in the UK:

- Trusts as investment entities: a trust will be an investment entity (and therefore a financial institution) where the trust or trustee engages another financial institution to manage the trust or financial assets on its behalf. A trust that purely holds a financial account with a financial institution, such as a depository account, and the financial institution does not participate in the management of the trust (or financial assets) would not make the trust an investment entity.
- As investment entities, this enables the trusts to potentially take advantage of being a Trustee Documented Trust (see below), Sponsored Investment Entity or Owner Documented FI.
- Trusts that are not investment entities: where a trust is not an investment entity it will be treated as a Non Financial Foreign Entity (NFFE). Where the
trust is a Passive NFFE, the financial institutions where the trust holds financial accounts will be required to undertake the necessary due diligence procedures to determine if any of these accounts are Reportable Accounts. Given the level of due diligence currently being undertaken we do not view this as being a material increase in the due diligence procedure.

- **Trustee Documented Trust**: for trusts that are investment entities and the Trustee of the Trust is a Reporting Model 1 FFI, the trust itself will be treated as a non-reporting UK Financial Institution and will not be required to register with the IRS provided the trustee reports all information required with respect to all US Reportable Accounts of the Trust.

- Taken as a whole, these changes are welcome relief for much of the trust industry. They have removed fears that each trust would have to become a registered FFI regardless and instead mean that the Trustees can register and fulfill the trust’s obligations for them. Whilst clearly there is still a compliance burden on the Trustees, this is much reduced and we believe successfully balances the compliance burden with practical considerations.

### Incorporation of deemed-compliant categories from the final FATCA regulations

The final Guidance Notes also incorporate detailed descriptions of the Registered Deemed-Compliant and Certified Deemed-Compliant categories contained in the US Treasury regulations, which were not originally mentioned specifically in the draft Guidance Notes:

- Registered deemed-compliant categories include: non-reporting members of participating FFI groups, qualified collective investment vehicles, restricted funds, qualified credit card issuers, and sponsored investment entities and controlled foreign corporations.

- Certified deemed-compliant categories include: non-registering local banks, financial institutions with only low-value accounts, sponsored closely held investment vehicles, limited life debt investment entities, and owner documented financial institutions.

- Whilst naturally limited in nature, the inclusion of the above categories is to be welcomed and should provide welcome relief for those within the definitions.

### Local client base financial institutions

The draft Guidance Notes provided nine criteria that must all be met before a financial institution can be treated as a Local Client Base Financial Institution. The final Guidance Notes add one additional criterion:

- The Financial Institution must not have policies or practices in place that discriminate against opening or maintaining accounts for individuals who are specified US persons and who are residents of the United Kingdom.

### Financial Accounts

For purposes of the UK IGA, the term Financial Account is broadly scoped and therefore may include products or obligations that would not normally be regarded as a financial account in either other UK legislation, or in everyday commercial use.

There are five categories of Financial Accounts:

- Depository Accounts
- Custodial Accounts
- Cash Value Insurance Contracts
- Annuity Contracts and,
- Equity and Debt Interests.

Items of note include:

#### Annuities

The Guidance expands on the definition of “annuity contract”, providing that for UK purposes an annuity contract:

- **Includes**: all annuities as outlined in HMRC manual IPTM4000 Purchased Life Annuities
- **Excludes**: pension annuities, immediate needs annuities, and periodic payment orders

Reinsurance of annuity contracts between two insurance companies are also excluded from this definition.

#### Debt or equity interests regularly traded on an established securities market

The final Guidance Notes provide that for purposes of the IGA, the term “listed on a recognised stock
exchange”, in respect of shares and securities, will take its meaning from section 1005(3) ITA 2007. Under that rule:

- Any equity or debt interest will be considered “regularly traded” if it is listed on a recognised stock exchange. There is no need to check annually if any transactions have been undertaken.
- Recognised stock exchange includes the London Stock Exchange, AIM and PLUS.

Undesignated and designated accounts

The guidance introduced a new account status, that of designated. A designated account is an account held with an FI, operated by a non FI but where the underlying client(s) of the intermediary are listed or can be identified by the FI.

Where a financial account is held by a non-Financial Intermediary who is holding funds for its clients (such as a solicitor holding funds of multiple clients in one account) the UK Financial Institution is only required to diligence on the non-financial intermediary if:

- The only person identified on the account is the non-financial intermediary and
- The non-financial intermediary is not required to disclose their underlying clients under AML/KYC or other regulatory requirements.

Segregated accounts

The Guidance defines segregated accounts as arrangements whereby the legal owner of assets directly appoints an investment manager to manage an account held at a custodian.

The Guidance clarifies that such accounts will not be the account of the investment manager but rather treated as custodial accounts maintained by a custodian. However, if the investment manager also holds assets as a custodian, the investment manager will be required to report as custodian.

Accounts of deceased persons

Accounts of deceased persons are not treated as financial accounts if the institution has received formal notification of death (such as a death certificate) and are not reportable in the year of the account holder’s death.

Due diligence for new and existing Financial Accounts

The guidance sets out how Financial Institutions should undertake the due diligence and the types of information that can be relied upon. This notably includes the rules around self-certification as well as KYC which many UK FIs will be seeking to rely upon.

Non IRS forms for individuals

The Guidance permits financial institutions to use their own form, which can be paper or electronic, instead of an official IRS form (i.e., a W-8 or W-9) - so long as the form is dated, signed, accompanied by documentary evidence that supports the individual's status, and the form contains the following information:

- The name and permanent residence address of the individual
- City/town and country of birth
- All countries that the individual is resident in for tax purposes
- Tax identification numbers for each country listed (if available).

Validity of documentation

A withholding certificate or other documentary evidence used to establish an account holder’s status will remain valid indefinitely subject to a change in circumstances which results in a change of the account holder’s status.

Self-certification for new individual accounts

Under the draft Guidance Notes, financial institutions were permitted to choose the form of the wording of the self-certifications it obtains from its new individual account holders. The draft Guidance Notes provided that it should be sufficient for an account holder to confirm that they are not a US citizen or considered to be resident for US tax purposes to complete the self-certification.

As evidence that information-sharing regimes similar to FATCA will be implemented more widely, the Guidance revises the requirement to read that:
• It should be sufficient for an account holder to confirm the country or countries where they are tax resident and if they are a US citizen.

Aggregation of Sponsored Funds

In some cases, sponsoring entities will be required to aggregate account balances across a range of funds that it sponsors.

• Aggregation is required across the range of funds that have the same sponsor where the sponsor or its service provider uses the same computerized systems to link the accounts.

• Where the fund sponsor (typically the fund manager) uses a service provider(s) (typically a transfer agent) to manage the client relationships of the account holders and different service providers are used by the same sponsor, the systems might not link account information across service providers. In this situation, aggregation would only be required at the level of the service provider (transfer agent).

Threshold exemptions

Under both the draft and final Guidance Notes, financial institutions may elect to apply certain threshold exemptions. The Guidance clarifies that:

• The election can apply to all financial accounts or to a clearly identifiable group of accounts (such as by line of business or the location of where the account is maintained)

• The form the election will take and the rules governing the election are yet to be decided and HMRC will consult with business on the most suitable approach

Reporting & Withholding

Account closures and transfers

The final Guidance Notes outline what information the Reporting UK Financial Institution will need to report.

The first deadline for reporting information to HMRC is 31 March 2015. The guidance sets out the timetable and information required both of which are line with expectations.

Some of the details around the format and method of transmission are still to be finalised.

Compliance

The guidance distinguishes between Minor Errors, such as data fields missing and Significant Non-Compliance which can be determined by either the IRS or HMRC.

The CRM is expected to discuss compliance with the Financial Institution and understand how the business intends to comply and, where appropriate, the systems and risk governance that relate to FATCA.

Although the SAO regime is not referred to in the Guidance, this appears to be a similar approach to that regime.

Registration

The Guidance confirms that each Reporting UK Financial Institution and any entity that is a Registered Deemed Compliant Entity will be required to register and obtain a Global Intermediary Identification Number (GIIN) from the IRS.

The IRS will publish guidance regarding the registration process soon, as the registration service is expected to be available from July 2013 and GIINs will be assigned to registered entities from the middle of October 2013.

UK Financial Institutions are not required to provide a GIIN in order to establish their FATCA status prior to 1 January 2015, provided they can confirm their status in another acceptable manner, including: providing a withholding certificate; providing a pre-FATCA Form W-8 with an oral or written confirmation that the entity is a U.K. financial institution; or informing the withholding agent that they are a UK financial institution.

Although many UK Financial Institutions will decide to register anyway by mid-October, this is a welcome confirmation that there is more time available to do this should businesses require it.
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