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U.S. DEMONSTRATES IMPORTANCE OF FATCA COMPLIANCE THROUGH RECENT INDICTMENT

A recent federal indictment demonstrates the strength of U.S. law enforcement efforts to combat offshore fraud and tax evasion and is the first case to charge crimes involving false filings and the use of nominee shareholders to circumvent FATCA reporting obligations.

In September 2014, pursuant to an undercover sting operation, a federal grand jury indicted a U.S. citizen, along with citizens of the Bahamas, Belize, and Canada and several offshore corporate service providers, for conspiring to execute an elaborate $500 million offshore securities fraud, tax avoidance and money laundering scheme.[1] The charged crimes involved completing false W-8BEN forms to conceal U.S. beneficial owners and circumvent FATCA reporting obligations. This appears to be the first time a FATCA violation was charged as an "overt act" in furtherance of a tax conspiracy and securities fraud case.

The case sounds a warning bell that U.S. authorities are serious about FATCA compliance. As the IRS-Criminal Investigations agent in charge of the matter stated, "[t]he enactment of the Foreign Account Tax Compliance Act (FATCA) is yet another example of how it is becoming more and more risky for U.S. taxpayers to hide their money globally."

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WHAT IS FATCA?

The Foreign Account Tax Compliance Act ("FATCA") is U.S. legislation targeted at tax evasion by U.S. tax payers with foreign accounts. FATCA was signed into law on March 18, 2010, and went into effect on January 1, 2013, with a series of deadlines to implement different aspects of the law. The U.S. Congress passed FATCA to curb offshore tax evasion by U.S. tax payers. The legislation was passed on the heels of a Congressional report that found U.S. taxpayers were hiding billions of dollars offshore using intricate structures and nominee corporations to avoid paying taxes.

To curb tax evasion, FATCA requires U.S. taxpayers to report certain foreign financial assets, including foreign financial accounts. FATCA also requires foreign financial institutions ("FFIs")[2] to conduct in-depth due diligence to identify and report all U.S. accounts[3] and other

[1] Indictment, *U.S. v. Bandfield, et al.*, No. CR 14-00476 (E.D.N.Y. Sept. 8, 2014).

[2] Any foreign entity conducting financial transactions may be considered an FFI and include banks, collective investment vehicles, hedge funds, private equity companies, investment banks, custodians.

[3] A "U.S. account" is a financial account held by a specified U.S. person or a U.S. owned foreign entity which has one or more substantial U.S. owners.

accounts with "substantial U.S. owners"[4] to the U.S. Internal Revenue Service ("IRS"). FFIs are expected to obtain this information from the account holders themselves. If the account holders do not provide this information ("recalcitrant account holders"), FFIs are required to automatically withhold a 30% tax on the recalcitrant account holders' qualifying "withholdable payments." [5]

Intergovernmental agreements ("IGAs") signed between the U.S. and other countries permit FFIs to fulfill FATCA requirements without violating local privacy and secrecy laws. The IGAs create a framework for implementing FATCA reciprocal reporting requirements to assist the foreign country in its own efforts to curb tax evasion. As of September 2014, 42 countries have signed IGAs and another 59 countries have agreed to the IGA in substance, though it has not been signed. The IGAs are published in two models: Model 1 and Model 2, which provide alternative means for complying with FATCA.

HOW DO FFIs COMPLY WITH FATCA?

First, FFIs must agree with the IRS to a number of reporting obligations by entering into an "FFI Agreement" through the IRS online registration portal.[6] Under the FFI Agreement, FFIs must conduct in-depth due diligence on its account holders. Due diligence includes obtaining information from account holders sufficient to determine whether an account is a U.S. account, to identify the U.S. account holders, and to electronically report, on an annual basis, information regarding the U.S. account holder's name, address, U.S. taxpayer identification number (TIN), account number, account balance, and net payments and deductions from the account assets. This means that FFIs will need to identify and report the beneficial owners for nominee accounts and nominee shareholders to the IRS.

FFIs that do not enter into an FFI Agreement, called "non-participating FFIs," can expect both reputational and business blowback. Non-participating FFIs would likely lose institutional credibility in the financial world, which could result in reputational damage and the loss of account holders, including correspondent banking relationships with compliant FFIs. Moreover, IGA countries may shun non-participating FFIs and pass laws prohibiting their operation from or within the jurisdiction.

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[4] "Substantial U.S. owners" are U.S. persons (with certain exceptions) who own directly or indirectly more than 10% of the stock (by vote or value) of a foreign corporation; profits and capital interests of the foreign partnership; or beneficial interests of any trust (other than a grantor trust, where a U.S. person is the owner for federal income tax purposes).

[5] "Withholdable payments" include any payment of interest, dividend, rent, salary, wages, premiums, annuities, compensation, remuneration, emoluments and other fixed or determinable annual or periodical gains, profits, and income from sources within the U.S. Withholding payments apply to gross proceeds even if there is a loss on sale or exchange of a U.S. stock, interest paid on deposits by foreign branches of domestic banks, or gross proceeds from the sale or other disposition of U.S. stocks and securities. Withholdable payments include passthru payments and foreign passthru payments to the extent they derive from withholdable payments.

[6] www.irs.gov/fatca-registration.

The deadline for FFIs to implement this reporting requirement is December 31, 2015 (or if later, two years after the effective date of the FFI agreement). However, certain preexisting accounts have an earlier deadline (e.g. the deadline for preexisting high-value individual accounts is December 31, 2014). Notably, the deadline to implement procedures to meet these requirements for new individual and entity accounts was January 1, 2014 (or if later, the effective date of the FFI agreement).

This whitepaper provides a brief overview of FATCA requirements for FFIs. However, FATCA is complex and we do not cover the scope of FATCA or its various exceptions. While the deadlines for meeting FATCA requirements may seem far into the future, developing and implementing systems to comply with FATCA will take time. We advise seeking U.S. counsel early to determine your particular FATCA obligations and devise a compliance program to ensure FATCA compliance on a going-forward basis. We would welcome the opportunity to develop such a program with you, and encourage you to reach out with specific inquiries as they arise.

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