
Implications of Implementing FATCA in the International Information Exchange Framework

Inter-Governmental Agreement – Model 1

Rome, 1st February 2013

Fabrizia Lapecorella
Direttore Generale delle Finanze
Ministero dell'Economia e delle Finanze

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

The starting point: US legislation.

- ❑ On March 2010, the Hiring Incentives to Restore Employment Act (the HIRE Act) added chapter 4 (of Subtitle A – sections 1471 through 1474) to the Internal Revenue Code of 1986. These provisions are commonly referred to as the Foreign Account Tax Compliance Act - “FATCA” .
- ❑ Chapter 4 generally requires US withholding agents to:
 - withhold tax on certain payments to: a) foreign financial institutions – FFIs that do not agree to report certain information to the IRS regarding their US accounts; b) “recalcitrant account holders” (those not available to disclose required information or to allow FFIs to report their information);
 - withhold tax on certain payments to certain non-financial foreign entities – NFFEs that do not provide information on their substantial US owners to withholding agents;
- ❑ - close accounts of “recalcitrant account holders”.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Purpose and rationale of US legislation:

- ❑ In today's global investment climate, US taxpayers have access both to domestic and international investment opportunities. In order to prevent the use of offshore accounts as a tool for tax evasion, foreign financial institutions – FFIs are required to identify and report with respect to their US customers.
- ❑ The purpose of FATCA US legislation is therefore to address offshore tax evasion through increased information reporting.
- ❑ In general terms, a system based on reporting both by US financial institutions and by FFIs with respect to both onshore and offshore accounts of US taxpayers places US taxpayers having access to international investment opportunities on an **equal footing** with US taxpayers not having such access (or otherwise choosing to invest within the US).

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Model Intergovernmental Agreements.

- ❑ Following the release of the “proposed regulations” for FATCA implementation (February 2012), the Treasury Department and the IRS received numerous comments from stakeholders, the majority of which focused on :
 - legal impediments to compliance in a number of jurisdictions;
 - implementation costs and burdens;
 - other practical aspects (e.g. procedures and systems of registering and reporting).
- ❑ In order to address and reduce these drawbacks – mainly with respect to legal impediments and excessive burdens on FFIs – a dialogue started between the US and other jurisdictions.
- ❑ As a result of this dialogue, two alternative Model Intergovernmental Agreements – IGAs have been developed.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Model 1 IGA.

- ❑ The first Model IGA was published on 26 July 2012.
- ❑ This Model Agreement has been developed by the US together with the Governments of France, Germany, Italy, Spain and the United Kingdom.
- ❑ In substance, Model 1 IGA builds on the shared objective of these States of combating international tax evasion through automatic exchange of information. Under Model 1 IGA, **FFIs** of the Partner Jurisdiction covered by the Agreement (not otherwise excepted or exempt from reporting) **will report** the relevant information **to their respective tax authorities** (instead of reporting directly to the IRS). The Partner Jurisdiction will then exchange this information with the IRS on an **automatic basis** (within the framework of the existing bilateral tax treaties).
- ❑ The main difference with Model 2 IGA is that the latter provides that FFIs located in the Jurisdiction signing such Agreement **report directly to the IRS**. In the case of recalcitrant account holders, this information is supplemented by government-to-government exchange of information on request.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Main features of Model 1 IGA:

- **addresses the legal issues** that had been raised in connection with the Foreign Account Tax Compliance Act (in many cases, foreign law would prevent an FFI from reporting directly to the IRS, thus potentially exposing – in the absence of a Model 1 IGA - the FFI to withholding);
- **simplifies the implementation** for financial institutions;
- in addition it provides for **reciprocity** in the **exchange of information**.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Main advantages for FFIs:

- the main **legal impediments** are addressed, e.g.:
- the Agreement constitutes a juridical basis for the provision of information required under FATCA legislation, therefore overcoming **data protection issues** otherwise related to direct reporting of information on FFIs clients;
- no obligation for FFIs to close accounts held by “recalcitrant” account holders;
- the reporting process by FFIs is simplified, given that FFIs will report to **their** Tax Authorities.
- **due diligence** requirements are aligned to anti-money laundering provisions, thus allowing FFIs to rely in most cases on information already available (e.g., 25% US substantial shareholding in place of the ordinary 10%).

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

- each **FFI** shall be treated as complying with section 1471 of the US Internal Revenue Code and **shall not be subject to 30% withholding** (provided by same section): the IGA acts as an “umbrella” for all FFIs located in the Jurisdiction that has signed the Agreement with the US
- the obligation of the 30% withholding on any US source withholdable payment to any Non-Participating Financial Institution is **limited** to FFIs acting as qualified intermediaries (**QIs**) that have elected to assume ***primary withholding responsibility***.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Content of exchange of information.

- ❑ IGA is essentially an Agreement on Exchange of Information.
- ❑ What information?
- ❑ The FATCA Partner Country shall obtain – and annually exchange on an automatic basis with the IRS – the information listed in IGA with respect to each US Reportable Account.
- ❑ A first “bulk” of information (to be exchanged no later than September 30, 2015) to be obtained with respect to **2013** and **2014** is the following :
 - **name, address**, and **US TIN** of each **Specified US Person** that is an Accountholder of such account. In the case of a **Non-US Entity** having (after due diligence procedures have been applied) one or more Controlling Persons that is a Specified US Person: **name, address** and **TIN** of such Entity and each such Specified US Person ;
 - **account number**, name and identifying number of the Reporting FFI, **account balance** or value.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

- As for **subsequent years**, the information to be obtained and exchanged (within 9 months after the end of the calendar year to which the information relates) is the following:
 - with respect to **2015** (besides the information previously mentioned), in the case of any **Custodial Account** (an account for the benefit of another person that holds any financial instrument or contract held for investment) the total gross amount of **interest, dividends and other income** generated with respect to the assets held in the account, paid or credited to the account. In the case of any **Depository Account** (any account maintained by a Financial Institution in the ordinary course of banking or similar business): the total gross amount of interest paid or credited to the account. For any account not described above: total gross amount paid or credited to the account.
 - with respect to **2016 and subsequent years** (besides the information previously mentioned), the total **gross proceeds** from the sale or redemption of property paid or credited to the custodial account during the calendar year.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Reciprocity: a significant further achievement.

- The US acknowledges the need to achieve equivalent levels of reciprocal automatic information exchange with the FATCA Partner.
- The US will provide FATCA Partner (e.g. Italy), with respect to each Italian Reportable Account of each Reporting US Financial Institution:
 - name, address and Italian TIN on any person that is a resident of Italy and is an Account Holder of the Account;
 - account number, name and identifying number of the Reporting US Financial Institution;
 - gross amount of interest paid on a Depository Account, gross amount of US source dividends paid or credited to the account, gross amount of other US source income paid or credited to the account.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Two further issues:

- - a **MAP** under the relevant Convention (DTA) shall establish the procedures for automatic exchange of information, any necessary procedures to implement collaboration on compliance and enforcement (Article 5 IGA, e.g. for minor and administrative errors and cases of significant non-compliance), the procedures for exchanging information on each Non-Participating Financial Institution to which the Reporting FFI has made payments and the aggregate amount of such payments [Article 4 1(b)];
- - any solution for the issues of withholding on **Passthru Payments** and **Gross Proceeds** has been deferred: the US and the FATCA Partner are committed to work together (the Parties shall consult prior to December 31, 2016), along with other partners, to develop a practical and effective alternative approach to achieve the policy objectives of foreign passthru and gross proceeds withholding that minimizes burden.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

On January 24 Italy has concluded the technical negotiations with the US on Annex II and has initialled the Agreement.

Content of Annex II.

- In general: Annex II allows to maintain a certain degree of flexibility, should it be necessary in future to update, through a mutual agreement, the categories of entities and products. This may work basically in two ways:
 - for the “better”, to include additional entities, accounts, and products that present a **low risk** of being used by US Persons to evade US tax and that have similar characteristics to the entities, accounts and products identified in Annex II;
 - for the “worse”, to remove entities, accounts and products that, due to changes in circumstances, **no longer present a low risk** of being used by US Persons to evade US tax.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Non-Reporting Italian Financial Institutions (1):

- **Exempt Beneficial Owners.** The categories that are treated as Exempt Beneficial Owners for the purposes of section 1471 of the US Internal Revenue Code are:
 - Governmental organisations (the Italian Government and any subdivision thereof, or any wholly owned agency of any of the foregoing);
 - International Organisations;
 - Central Bank of issue (Banca d'Italia);
 - certain retirement funds (a fund or an institutions qualifying as a retirement fund under Italian law, including pension funds regulated by Legislative decree n. 252/2005 and provident and social security institutions privatized by Legislative decree n. 509/1994, or founded according to Legislative decree n. 103/1996), provided that individual voluntary contributions to the account are either limited by the relevant Italian law or do not exceed 50.000 euro in any year.

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Exempt products:

- A retirement account, including an individual pension plan issued by an Italian licensed insurer, that meets the following requirements: a) the account is subject to government regulation as a personal retirement account or is registered or regulated as an account for the provision of retirement or pension benefits under the laws of Italy; b) individual voluntary contributions to the account are either limited by the relevant Italian law or do not exceed 50.000 euro in any year;

- Contracts taken out by employers to ensure workers for the payment of severance indemnity (polizze collettive TFR a favore dei dipendenti).

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

Non-Reporting Italian Financial Institutions (2):

- **Deemed-Compliant Financial Institutions.** The categories that are treated as deemed-compliant FFIs for the purposes of section 1471 of the US Internal Revenue Code are:
 - Local Financial Institutions (that meet the requirements described in Annex II);
 - Collective Investment Vehicles (that meet the requirements described in Annex II);
 - Non profit organisations (Onlus)

Model Intergovernmental Agreement to Improve Tax Compliance and Implement FATCA (Model 1)

- A number of States (e.g. UK, Mexico, Denmark) has already concluded a Model 1 IGA with the United States.
- Once our Agreement with the United States is signed, Italy shall ratify it with a law. The Parties shall notify each other in writing when their necessary internal procedures for entry into force have been completed. The Agreement shall enter into force on the date of the later of such notifications.

The exchange of the Italian IGA!

