

United Kingdom and United States Conclude FATCA Intergovernmental Agreement

September 25, 2012

On September 12, 2012, the United Kingdom became the first government to enter into an agreement (the "Agreement") with the United States regarding the U.S. withholding tax regime commonly referred to as the Foreign Account Tax Compliance Act ("FATCA").

[\[1\]](#) The Agreement is based on the model "reciprocal" intergovernmental agreement published on July 26, 2012. A U.S. Treasury Department press release of September 14, 2012 states that the U.S. is in communication with several other governments and expects to sign additional bilateral agreements in the near future, as well as reiterating that the U.S. tax authorities are continuing work on finalizing the proposed U.S. Treasury regulations promulgated under FATCA.[\[2\]](#)

Following publication of the Agreement, the U.K.'s HM Revenue and Customs ("HMRC") issued a consultation document (the "Consultation") requesting comments on the implementation of the Agreement. The Consultation states that U.K. legislation implementing the Agreement is expected to be included in Finance Bill 2013.

A stated aim of the Agreement is to provide for the implementation of FATCA based on domestic reporting and to improve reciprocal information sharing between the two countries. The Agreement will enter into force when both countries have notified the other in writing that their respective internal procedures for entry into force have been completed.

Read this alert to learn more about the Agreement and its principal effects. If you would like to discuss the effect of the Agreement on your particular circumstances, or FATCA-related matters generally, please contact any of the lawyers listed on this alert or the member of the Proskauer Tax Group with whom you normally consult on these matters.

Main features of the Agreement

To summarise, under FATCA, most non-U.S. financial institutions, including investment funds, may enter into an agreement with the Internal Revenue Service ("IRS") to provide certain information concerning their U.S. account holders. Although entry into such agreement with the IRS is not technically mandated by the statute, failure to do so will result in a 30 percent withholding tax on U.S.-source income and gross proceeds and on certain "passthru payments", unless the financial institution is treated as "deemed compliant" with respect to FATCA.

The expected terms of such agreements and the associated diligence and reporting requirements raised concerns not only about the substantial compliance burdens for non-U.S. financial institutions, but also about whether there would be legal impediments to complying with such agreements for financial institutions located in certain jurisdictions, including the U.K.

Under the Agreement, financial institutions resident in the U.K. that would otherwise be required to disclose the existence and identity of U.S. account holders directly to the IRS to avoid the 30 percent withholding tax instead must provide substantially similar information to HMRC, subject to exemptions for certain "non-reporting" U.K. financial institutions. HMRC will then pass this information on to the IRS.

U.K. financial institutions also are subject to due diligence requirements, set out in the Agreement, which largely mirror those of FATCA but with certain features more akin to the U.K.'s anti-money laundering rules. Thus, the Agreement enables U.K. financial institutions to comply with FATCA on a local level, lessening the administrative burden of the statute and removing certain of the legal impediments to compliance, while avoiding the 30 percent withholding tax. In addition, a U.K. financial institution must comply with the registration requirements applicable to non-U.S. financial institutions in other jurisdictions where the United States enters into intergovernmental agreements. In certain cases, it also must agree either to withhold on U.S.-source withholdable payments itself or provide to the immediate payor of such U.S.-source withholdable payments the information required for such withholding.

Interestingly, compliance with the Agreement, unlike FATCA, is mandatory. Penalties under U.K. legislation for non-compliance have not yet been fixed, and as part of the Consultation, HMRC is asking for comments on the approach to be taken. Ultimately, a U.K. financial institution that fails to comply could become subject to FATCA withholding in respect of U.S.-source withholdable payments, but only after the IRS identifies the financial institution as non-compliant, which could only arise after, at a minimum, 18 months of HMRC enforcement efforts after the IRS notifies HMRC of the financial institution's non-compliance.

In exchange, U.S. financial institutions will be required to report certain, albeit more limited, information to the IRS regarding their U.K. account holders, and the IRS will in turn pass that information to HMRC. Such U.S. institutions, however, are not subject to the same due diligence requirements as U.K. institutions under the Agreement.

There are some slight differences between the definitions of financial institution in the Agreement and in FATCA itself; for example, family offices and trusts may not be within the scope of the Agreement if they do not have a "customer", and may therefore have to comply with FATCA directly to avoid the withholding tax. However, investment funds should generally be caught by both definitions.

The Agreement also clarifies certain U.K. entities that are regarded as "non-reporting" and thus exempt from the reporting requirements, including local government authorities, the Bank of England, pension funds (as defined in the U.K./U.S. Double Tax Treaty), financial institutions with a local client base and U.K. registered charities.

Application to investment funds

One very important and unanswered question is whether a U.K. investment fund partnership will be viewed as a U.K. "resident" for purposes of the Agreement. If not, the Agreement does not apply, and the U.K. investment fund would be required to enter into an agreement directly with the IRS to avoid the 30 percent withholding tax. Under U.K. law, an English partnership is not a legal entity and therefore does not have a "residence" for tax purposes; similar principles apply to Scottish partnerships. However, there is U.K. case law which suggests that, where an international agreement is intended to cover partnerships, a partnership may have a residence for the purposes of such agreement. Under such case law, the residence will most likely be determined by the location of the management and control of the partnership concerned.

If this principle were applied to the Agreement, investment funds structured as English or Scottish limited partnerships with English or Scottish general partners and a U.K. manager should be in a position to benefit. However, it is common for funds formed as English or Scottish limited partnerships to have an offshore general partner, usually based in Jersey or Guernsey. Depending on the level of activity carried out in the U.K., such funds may not be covered by the Agreement if their management and control would more appropriately be determined to be offshore. Currently, neither Guernsey nor Jersey has entered into an agreement with the United States in relation to FATCA. Hence, such funds may be required to comply with FATCA by way of arrangements with the IRS, notwithstanding the provisions of the Agreement. On a similar note, partnerships formed under non-U.K. laws may conceivably be able to benefit from the Agreement if, for example, they have a U.K. manager and it can be said that the partnership is managed and controlled in the U.K. and nowhere else.

The Agreement provides for the competent authorities of both jurisdictions to agree to the meaning of any term not defined. The term "resident" is not specifically defined. The Consultation invites comments on any definitions requiring greater clarity, and the fund industry can be expected to raise this point.

Conclusion

The prompt action of the U.K. and U.S. governments in entering into the Agreement is encouraging. We expect issues relating to the scope of the Agreement as regards partnerships will be raised with HMRC, and hopefully clarified, shortly.

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[\[1\]](#) Sections 1471–1474 of the U.S. Internal Revenue Code of 1986, as amended.

[\[2\]](#) The proposed regulations were issued by the Treasury Department and the Internal Revenue Service in a Notice of Proposed Rulemaking (Reg-121647-10, Feb. 8, 2012) and have been the subject of extensive and ongoing commentary. They were accompanied by a Joint Statement between the United States and key trading partners, including the United Kingdom, regarding an intergovernmental approach to international tax compliance and implementing FATCA, and which proposed the possibility of intergovernmental agreements such as the Agreement.

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