KPMG – TAX NEWS FLASH

On 7 August 2013, UK regulations (SI 2013/1962) ("the UK Regulations") were laid to bring into effect the intergovernmental agreement on FATCA between the UK and the US ("the IGA").

On 14 August 2013 HMRC also issued guidance notes on the UK Regulations. Although these guidance notes were issued as "final", we are expecting further updates on a regular basis.

The UK Regulations and the HMRC guidance notes seek, among other things, to clarify and expand upon the meaning of certain terms and the obligations of financial institutions resident in the UK.

Key recent changes in the UK Regulations and HMRC guidance notes

We have previously commented on the main developments of the draft UK regulations and the draft HMRC guidance notes.

The final enacted UK Regulations and HMRC guidance notes have confirmed that:

- The effective date for the start date of the regulations is now confirmed as 1 September 2013;
- The UK Regulations and guidance has been updated to conform with the delayed FATCA implementation milestones (as notified in IRS Notice 2013-43);
- The Investment Entity test is determined by reference to regulation 14F of Part 2B of the Authorised Investment Funds (Tax) Regulations 2006(d);
- A Holding Company now includes a "qualifying relationship" test based on being connected within the meaning of section 1122 of CTA 2010;
- The UK Regulations require the identification of either the income tax or corporation tax residency of all account holders (not just for those with US indicia); This provides some "future-proofing" for other FATCA style regimes in the future; and
- The tests for reportable payments of UK Financial Institutions are included in the UK Regulations.

So where does this leave us now?

- Given the volume of new legislation and guidance material now available, as well as significant industry commentary over the past 6 to 12 months, it is worthwhile stepping back to consider, from a high level, what the new regulations will mean for UK financial institutions.

Which entities are in scope?

Residence test

- The UK Regulations will generally apply to financial institutions "resident" in the UK and UK branches of non-UK resident financial institutions within the charge to UK corporation tax. Non-UK subsidiaries (of UK residents) and non-UK branches (of UK residents) should be out of scope, as these will be subject to the FATCA regulations in place in their own territory.
- There are special rules for partnerships and trusts, dual resident entities are in scope (although they should only apply the UK regulations for Reportable Accounts located in the UK only) and the US "check the box" designation is generally ignored for these purposes.

Definition of UK Financial Institutions

There are six categories of UK Financial Institutions under the UK Regulations. A high level summary of these is as follows:

- *A custodial institution* – An entity that holds financial assets for the accounts of others as a substantial portion of its business. "Substantial" includes where >20% of gross income is generated from custodial activities (in a certain period).
- *A depository institution* – Defined by reference to provisions in the Financial Services and Markets Act 2000 and the electronic Money Issuers Regulations 2011. This also includes entities issuing pre-payment cards with funds/balances in excess of $50,000.
- *An investment entity* – Those undertaking certain activities on behalf of customers (including trading (e.g. money markets, foreign exchange etc), portfolio management and otherwise investing, administering, or managing funds or money on behalf of other persons). The UK Regulations further extends this definition by reference to regulation 14F of Part 2B of the Authorised Investment Funds (Tax) Regulations 2006(d).
- *A specified insurance company* – broadly includes a company (and potentially its holding company) which provides cash value insurance products or annuity contracts. This should generally exclude insurance companies that only provide, for example, general insurance or term life insurance.
- *A relevant holding company* – generally holding companies of other "Financial Institutions". The UK regulations now include a "qualifying relationship" test based on being connected within the meaning of section 1122 of CTA 2010;
- *A treasury company* – generally one whose primary activity includes entering into hedging and financial transactions with or for related entities that are "Financial Institutions".

Reporting vs. Non-Reporting UK Financial Institutions

A UK Financial Institution should then be considered as either a:

- *Non-Reporting UK Financial Institution* – This includes any UK Financial Institution specifically identified as such in the IGA (Annex II.2), or one which otherwise qualifies under the IGA. This will generally include UK Government organisations, the Bank of England, UK offices of international organisations (IMF, World Bank etc.) and retirement funds. Other Deemed Compliant Financial Institutions include non-profit organisations (registered charities), and Financial Institutions with a "local client base".
- A Financial Institution with a "local client base" could include Credit Unions, Industrial and Provident Societies, Building Societies, Mutual Societies, Investment Trust Companies and Venture Capital Trusts. Several requirements must be met, which as the term suggests, are focused on ensuring that the entity does not solicit business to non-UK residents and that the vast majority (>98%) of accounts are held by UK residents. The entity must also be UK regulated and not have a fixed place of business outside the UK. It must not provide accounts to non-UK resident Specified US Persons and other certain institutions named in the IGA (e.g. a Non-Participating Financial Institutions) and have certain controls in place (by 1 January 2014) to monitor this.
- *Reporting UK Financial Institution* – Any UK Financial Institution that is not a Non-Reporting Financial Institution.

A Non-Reporting UK Financial Institution should not generally need to carry out any due diligence or reporting obligations under the UK Regulations. However, there are some instances where an entity deemed compliant due to its "local client base" will still need to undertake due diligence and/or reporting.

Reporting UK Financial Institutions will be responsible for ensuring that their relevant due diligence and reporting requirements are satisfied.

Financial Accounts in scope

A Reporting UK Financial Institution must report certain information to HMRC on an annual basis on its Financial Accounts held by Specified US Persons. There are five categories of Financial Accounts including Depository Accounts, Custodial Accounts, Cash Value Insurance Contracts, Annuity Contracts and Equity and Debt Interests.

These categories are subject to various exclusions and exemptions. In particular, the IGA specifically exempts certain retirement accounts or products and certain other "Tax-Favoured" accounts or products (such as ISAs, Child trust Funds etc).

US Reportable Accounts

A Financial Account is a US Reportable Account where it is held by one or more Specified US Persons, or by a Non-US Entity with one or more Controlling Persons that are themselves Specified US Persons.

A US Person generally includes a US citizen or resident individual, a partnership or corporation organised in the US. There are then various exclusions to determine if a US Person is a "Specified US Person" (for example, listed corporation are generally excluded).

Due diligence requirements

A Financial Institution must follow one or more of the following three processes in order to identify account holders:

- *Indicia search* – searching account records and Know Your Customer (KYC) information for any prescribed US indicia;
- *Self certification* – obtaining self certification from account holders;
- *Publicly available information* – determining FATCA status based on information in the public domain.

There are complex rules on what constitutes acceptable documentation, what is required where information changes and document retention requirements. Different controls and processes are required for pre-existing vs. new accounts. Materiality thresholds will determine high-value vs. low value accounts and the resulting processes required.

It is important to note that the UK Regulations require the identification of either the income tax or corporation tax residency of all account holders (not just for those with US indicia). Whilst the immediate reporting obligations relate only to US indicia, this provides some "future-proofing" for other FATCA style regimes which could be enacted.

Non-Participating Financial Institutions as counterparties

In addition, controls and procedures must also be in place to identify payments made in the 2015 to 2016 calendar years to Non-Participating Financial Institution (a Non-Participating Financial Institution is broadly one which is not FATCA compliant). There are specific reporting requirements for all payments made to such counterparties (see below).

Reporting obligations for Reporting UK Financial Institutions

A Reporting UK Financial Institution must prepare an annual return setting out certain information in relation to Reportable Accounts. The report will be due on or before 31 May of the year following the calendar year to which the return relates. The first return should therefore be due on 31 May 2015 for the 2014 reporting year.

General reporting requirements

For each Specified US Person holding an individual reportable account and for each Specified US Person who is a controlling person of an entity account, the following general information will be reportable to HMRC:

- Name;
- Address;
- US Tax Identifying Number (to be phased in from 2017 onwards where this information is not otherwise available, but replaced with a date of birth for individual account holders);
- Account number (or functional equivalent);
- The name and identifying number of the Reporting Financial Institution;
- The account balance or value as of the end of the calendar year (or other appropriate period as defined).
- Relevant Gross Credits for the calendar year, the definition of which differs for Custodial Accounts, Depository Accounts or other Reportable Accounts.

The Relevant Gross Credits requirement will be phased in over the years 2014 to 2016. The current regulations state this is the case for Custodial Accounts only, however HMRC has confirmed that this should also apply to Depository Accounts and Other Accounts and that this error will be corrected in due course.

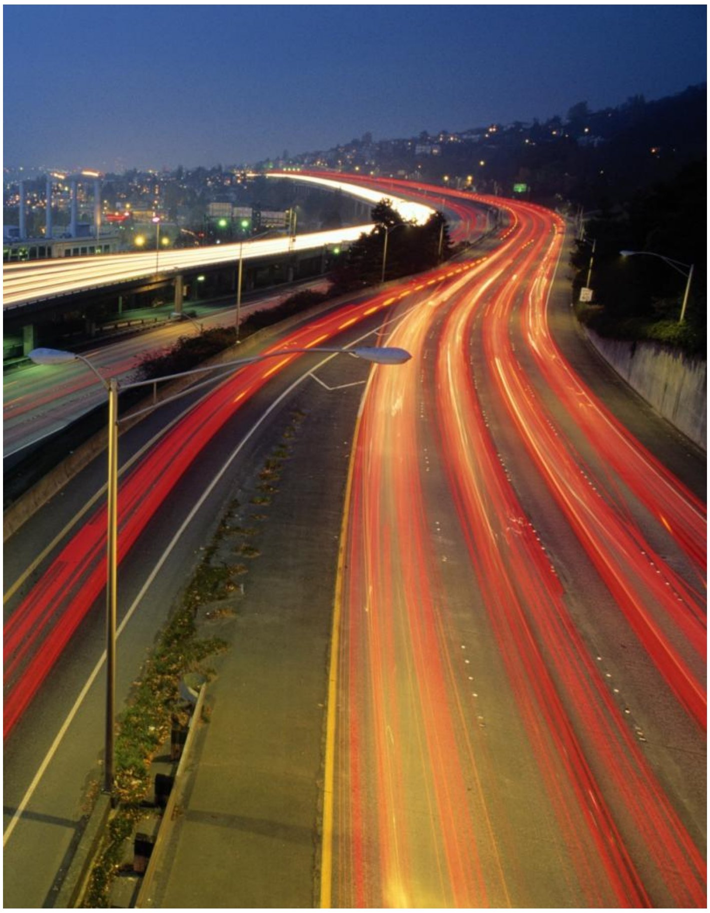
Payments to Non-Participating Financial Institutions

In addition to the general reporting requirements above, for the 2015 and 2016 calendar years, a Reporting UK Financial Institution must report the name and aggregate value of payments it makes to each Non-Participating Financial Institution.

This measure is seen as a temporary solution to the "pass-though" payment requirements in the US FATCA provisions.

Other compliance issues

- *Errors and non-compliance* – For minor errors in information reported, HMRC has the power to resolve this directly with the UK Financial Institution. Significant Non-Compliance (as determined by either HMRC or the IRS) must be rectified in an 18 month period. Continued Significant Non-Compliance could lead to the financial institution being treated as a Non-Participating Financial Institution (i.e. not FATCA Compliant).
- *Penalties* – The UK Regulations can impose penalties for non-compliance or inaccurate information. These range from £300 for each offence to a cap of £3000 for each calendar year. Repeated penalties may constitute significant non-compliance.
- *Tax Compliance Risk Management Process* – HMRC's Customer Relationship Manager will include FATCA as part of the regular dialogue with a financial institution, and could impact an entity's HMRC risk rating.



Key messages for UK Financial Institutions

1. **Action is required –** The HMRC Guidance Notes summarises the key questions succinctly as follows:
   - Am I a Financial Institution?
   - Do I hold Financial Accounts?
   - Are there indicators that any of the account holders are Specified US Persons?
   - After applying the relevant due diligence, do I have any Reportable Accounts?

   Despite the six month extension to the FATCA milestones, answering the above questions will still pose a significant due diligence exercise for UK Financial Institutions.

2. **Future-proofing –** the UK Regulations require a Reporting UK Financial Institution to establish the **tax residency of all** account holders. This is to minimise future implementation costs of other FATCA style regimes. HMRC expect the relevant systems to be in place within a "reasonable time" after 1 September 2013 (i.e. when the law is enacted).

3. **Reporting to HMRC only –** There should generally be no requirement to report any information direct to the IRS (apart from certain registration responsibilities for certain deemed compliant entities).

4. **Counterparty classification –** Are controls in place to identify or limit business undertaken with Non-Participating Financial Institutions?

5. **Is there any US Withholding tax? –** As long as UK Financial Institutions are in compliance with the UK regulations then they should not be subject to any US withholding tax on their US source income (under the FATCA provisions).

6. **Exempt entities and accounts/products –** The list of Non-Reporting and Deemed Compliant entities as well as Exempt Products (in Annex II of the IGA) can be updated by mutual consent of the UK and US governments. This should be monitored for developments.

7. **Other IGA agreements –** With more than 75 IGAs being negotiated by the US Treasury, there is significant potential for change from a global perspective. This could result in different scope and reporting requirements for non-UK subsidiaries and branches, and therefore increased complexity in controls and processes.

8. **US FATCA Portal and registration –** The IRS has now unveiled its new FATCA registration portal and has issued guidance notes. Developments can be followed on our US FATCA portal.

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