THE U.S./U.K. INTERGOVERNMENTAL AGREEMENT AND ITS IMPLEMENTATION*,**, Synopsis

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§16.01 INTRODUCTION

[1] Background to the U.K. IGA

The U.S. introduced FATCA as part of the Hiring Incentives to Restore Employment Act of 2010.¹ Its function, as discussed elsewhere in this book, is to require financial institutions outside the U.S. to report information on U.S. account holders to the IRS, with the penalty for non-compliance being the “big stick” of a 30% U.S. withholding tax on payments made to them.

In the U.K., concerns were raised by the financial sector about the legal difficulties it would face complying with FATCA reporting, particularly in respect to U.K. data protection laws, and thus the potential impact of withholding on U.S. source payments on the competitiveness of U.K. financial institutions.

In response, the U.K. Government, along with the governments of France, Germany, Italy and Spain entered into discussions with the U.S. to address the implementation of FATCA, resulting in the publication of a Joint Statement on February 8, 2012 setting out an agreement to explore an intergovernmental approach; and followed by the Model Intergovernmental Agreement to Improve Tax Compliance to Implement FATCA, published on July 26, 2012.² The U.K. then moved to enter into a bilateral intergovernmental agreement (an "IGA") based on this Model Agreement, which was signed on September 12, 2012, the first such IGA.

Described by the U.K. tax authority as a "landmark agreement … [setting] a new standard in tax transparency",³ the stated purposes of the U.K. IGA are to: address the data protection issues with compliance; align reporting requirements with existing anti-money laundering processes; avoid withholding to and by U.K. FIs; provide for a wider category of

¹ FATCA is the acronym used to describe the “Foreign Account Tax Compliance” provisions enacted in Chapter 4 of Subtitle A of the United States Internal Revenue Code 1986 and the supporting Treasury regulations.
² In light of the Model 2 IGA issued by the U.S. Treasury Department on November 15, 2012, this is now commonly referred to as the Model 1 IGA.
³ Paragraph 1.1, HMRC Summary of Responses dated December 18, 2012 (the "Summary of Responses").
effectively exempt institutions and products; and establish an element of reciprocity so that the U.K. receives something from the U.S. in return.\footnote{Paragraph 1.14, HMRC Consultation Document dated September 18, 2012 (the "Consultation Document").}

For financial institutions in the U.K. it is therefore intended that compliance with the U.S. Internal Revenue Code (the "Code") will be superseded by equivalent obligations under the U.K. IGA and its implementing legislation,\footnote{This should get around the data protection issues as, according to guidance produced by the UK tax authority, reporting by financial institutions will be required under a legal obligation. Consent of account holders should no longer be needed for their information to be reported, albeit that account holders will need to be made aware of the fact that their accounts have been reported. \url{http://www.hmrc.gov.uk/budget-updates/march2012/draft-dpa-fatca-faqs.pdf}.} with the U.K., in the first instance, responsible for enforcement of these obligations, in place of U.S. withholding.


Further to entering into the IGA, on September 18, 2012, the U.K. tax authority (Her Majesty's Revenue & Customs, "HMRC") issued a consultation paper on implementing the U.K. IGA. Draft primary legislation followed on December 11, 2012 as part of the Finance Bill 2013, and accompanying draft secondary legislation, \textit{the International Tax Compliance (United States of America) Regulations 2013} (the "Regulations") and draft HMRC Guidance (the "Guidance") were issued on December 18, 2012. This primary and secondary legislation is likely to come into force in mid-July together with the rest of the Finance Bill 2013.

[3] Focus of this Chapter

This Chapter describes a rapidly developing area of law. At the time of writing,\footnote{Late January 2013.} the U.K. implementing legislation remains in draft form\footnote{Indeed certain provisions remain in square brackets (see Regulations 5(2); 5(4)).} and HMRC acknowledges that there are a number of areas (for example, the details of how financial institutions will register with the U.S. and the format of reporting) which remain outstanding and subject to further discussion with the U.S.

Furthermore, the U.K. IGA may itself change. The IGA contains a "most favored nation" clause which provides that, should the U.S. enter into an IGA with another jurisdiction on improved terms, the U.K. IGA will be deemed to include those improved terms.

Given this background, this Chapter does not hold itself out to be a definitive description of the final legal position. Rather it should be used as a checklist of the relevant issues to consider and an indication of the approach currently being adopted by HMRC and the U.K. Government to FATCA.

The Chapter considers the scope, compliance obligations, effect and enforcement of the U.K. IGA from the perspective of U.K. financial institutions. While a significant aspect of the U.K. IGA is that it provides for information relating to U.K. account holders in the U.S. to be passed on to HMRC, the reporting requirements in respect to U.S. entities\footnote{Article 2.2(b) UK IGA; Article 3.4 UK IGA.} are not covered here.
[See Chapter 12]; and neither are the mechanics of automatic information exchange between the two jurisdictions [See Chapter 25].

Finally, it is important to note that this Chapter relates only to the U.K. IGA. Other jurisdictions may enter into agreements on very different terms, for example, as noted in Chapter 15, agreements based on the Model 2 IGA, which require financial institutions to continue to report directly to the IRS. The following comments would therefore not be relevant to financial institutions in those jurisdictions.

§16.02 SCOPE OF THE U.K. IGA

[1] Financial Institutions

The compliance obligations and relieving provisions imposed by the U.K. IGA and implementing regulations apply to any entity that is a Reporting United Kingdom Financial Institution (RUKFI). This definition comprises a number of concepts, not all of which are straightforward.

Firstly, the U.K. IGA only applies to a Financial Institution (a FI). This is defined as a Custodial Institution, a Depository Institution, an Investment Entity or a Specified Insurance Company, which in turn are defined as follows.

A Custodial Institution is an entity that holds, as a substantial portion of its business, financial assets for the account of others. This means that 20% or greater of the entity’s gross income (in the period of the shorter of the last 3 accounting periods or since it commenced business) is attributable to the holding of assets on behalf of others and from related financial services. HMRC Guidance notes that such institutions could include brokers, custodial banks, trust companies, clearing organizations and nominees.

A Depository Institution is any entity that accepts deposits in the ordinary course of a banking or similar business. This has been further defined in the Regulations, in response to comments received from stakeholders, by reference to existing U.K. definitions contained in the Financial Services Markets Act 2000 and the Electronic Money Issuers Regulations 2001. HMRC is of the view that entities within this definition could include, for example, entities regulated in the U.K. as a savings or commercial bank, a credit union, industrial and provident societies and building societies.

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9 Articles 2 and 4 UK IGA; Regulation 4, Reporting UK Financial Institutions are referred to as “reporting financial institutions” in the draft Regulations.
10 Article 1.1(g) UK IGA; Regulation 4.
11 Article 1.1(h) UK IGA.
12 Paragraph 2.11, draft Guidance.
13 Article 1.1(i) UK IGA.
14 Paragraph 3.7, HMRC Consultation Document. Particular concerns were raised about the potentially wide meaning of the term “similar”.
16 A person meeting the description in any sub-paragraph of regulation 2(1) of the Electronic Money Issuers Regulations 2011, other than sub-paragraph (f) or (g).
17 Paragraph 2.12, draft Guidance.
An Investment Entity is an entity which conducts as a business, or is managed by an entity that conducts as a business, one or more of the following activities for or on behalf of a customer: trading in money market instruments, foreign exchange, interest rate and index instruments, transferable securities and commodity futures trading; individual and collective portfolio management; otherwise investing, administering, or managing funds or money on behalf of other persons.\textsuperscript{18}

Finally, a Specified Insurance Company is an entity that is an insurance company (or the holding company of such) that issues or is obliged to make payments under a Cash Value Insurance Contract\textsuperscript{19} or Annuity Contract.\textsuperscript{20} It is HMRC’s view that insurance companies that only provide general insurance or term life insurance should not be FIs under this definition.\textsuperscript{21}

In implementing the U.K. IGA, the draft Regulations and accompanying Guidance provide specific rules for the treatment of collective investment schemes, fund distributors, trusts and partnerships. While the detail is outside the scope of this Chapter, it is worth noting that collective investment vehicles,\textsuperscript{22} as well as entities capable of investing, administering or managing them (including fund and investment managers, fund administrators and trustees of unit trusts), will be treated as Investment Entities. However, in light of concerns raised by stakeholders about overlapping reporting obligations, the draft Regulations provide that, in effect, it is only the scheme vehicle that is the reporting FI in respect of the interests in the scheme.\textsuperscript{23}

Fund distributors (for example, independent financial advisors, fund platforms and wealth managers) which hold legal title to assets on behalf of customers and are part of the legal chain of ownership of interests in collective investment vehicles will be FIs (either as Custodial Institutions or Investment Entities), while those that act in an advisory-only capacity (and thus are not in the chain of legal ownership) will not.\textsuperscript{24}

\textsuperscript{18} Article 1.1(j) UK IGA, HMRC Guidance at 2.13 notes that this should be interpreted in line with the definition of “financial institution” in the Financial Action Task Force Recommendations.

\textsuperscript{19} A “Cash Value Insurance Contract” is a contract under which the issuer agrees to pay an amount upon the occurrence of a specified contingency involving mortality, morbidity, accident, liability, or property risk and that has a Cash Value of more than $50,000, where the Cash Value is the greater of the amount that the policyholder is entitled to receive upon surrender or termination of the contract, and the amount the policyholder can borrow under or with regard to the contract. See Article 1.1(w);(y);(z) UK IGA.

\textsuperscript{20} An “Annuity Contract” means a contract under which the issuer agrees to make payments for a period of time determined in whole or in part by reference to the life expectancy of one or more individuals. The term also includes a contract that is considered to be an Annuity Contract in accordance with the law, regulation, or practice of the jurisdiction in which the contract was issued, and under which the issuer agrees to make payments for a term of years. See Article 1.1(x) UK IGA.

\textsuperscript{21} Paragraph 2.15, draft Guidance.

\textsuperscript{22} The same definition applies as for FSMA 2000: Regulation 6(5).

\textsuperscript{23} Regulation 6; Paragraph 2.15, draft Guidance; Paragraph 3.13(i) Summary of Responses.

\textsuperscript{24} Paragraphs 2.16-2.18, draft Guidance.
Trustees are FIs only if they are independent legal professionals or a trust or company service provider, while HMRC Guidance notes that trusts themselves, although entities for the purposes of the U.K. IGA, will in most cases be regarded as Non-Financial Foreign Entities (NFFEs).

Partnerships will also be entities for the purposes of the U.K. IGA and so potentially within scope. Whether they are FIs and have reporting obligations will depend on the activities they undertake.

[2] United Kingdom

To be within scope of the U.K. IGA, an FI must be resident in the U.K. (and in this respect overseas branches of U.K. resident FIs are excluded) or a branch of a non-resident FI located in the U.K. (together “UKFIs”). Thus in the illustrative group structure below, A, B, F and G will all be UKFIs for the purposes of the U.K. IGA. C meanwhile would be expected to report to the tax authority in the jurisdiction where it is resident (as provided for in the relevant IGA) and E will be required to report to the IRS on accounts held by U.K. account holders. Whether D is able to comply with FATCA will depend on whether the domestic law to which it is subject allows it to report information directly to the U.S.

![Illustrative financial group structure](image)

*Figure 1. Illustrative financial group structure.*

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25 Regulation 7(1). “Independent legal professional” and “trust or company service provider” take the meaning given by regulation 3 of the Money Laundering Regulations 2007.

26 Paragraph 2.20, draft Guidance. For more on the entities considered NFFEs and their FATCA obligations see Chapter 8 infra.

27 Paragraph 2.21, draft Guidance.

28 Article 1.1(1) UK IGA.
The Guidance notes that in situations where it is not obvious where an FI is resident or located it will be necessary to determine its tax residence.\(^2\) The U.K. test for the tax residence of a company is whether the company is (a) incorporated or (b) centrally managed and controlled in the U.K.; for branches, tax residence is established to the extent a trade is carried out in the U.K. through a permanent establishment.\(^3\) The Guidance further notes that if an entity is dual resident in the U.K. and another country then it still will need to apply the U.K. legislation.\(^4\)


The U.K. IGA and Regulations make the distinction between RUKFIs and Non-Reporting U.K. Financial Institutions (NRUKFIs), with RUKFIs required to comply with the various specified due diligence and reporting obligations. NRUKFIs do not have obligations under the IGA and Regulations,\(^5\) but shall regardless be treated as a deemed-compliant FFI or an exempt beneficial owner for the purposes of IRC Section 1471.\(^6\)

RUKFIs are defined as any UKFIs that are not NRUKFIs,\(^7\) either as identified in Annex II of the U.K. IGA, or that otherwise qualify as deemed-compliant FFIs, exempt beneficial owners or excepted FFIs under FATCA.\(^8\)

Annex II is likely to be one of the most heavily negotiated sections of future IGAs and is intended to identify entities which are considered to present a low risk of being used by U.S. persons to evade U.S. taxes.\(^9\) In the U.K. IGA, the entities listed in Annex II are:

- U.K. Governmental organisations;
- The Bank of England and its wholly owned subsidiaries;
- Any U.K. office of various international organisations including the IMF, the World Bank and the EC; and
- Retirement Funds.

- Certain non-profit organisations (including registered charities)\(^10\)
- Financial Institutions with a local client base.\(^11\)

Exempt Beneficial Owners

Deemed-Compliant Financial Institutions

\(^2\) Paragraph 2.22, draft Guidance. Note that the Regulations currently apply to a “person who carries on business in the United Kingdom as a [financial institution]”. This could be viewed as a wider test of “UK” than that specified in the UK IGA, but does not appear to be reflected in the Guidance which broadly references the test of residence from the UK IGA.

\(^3\) Paragraph 2.22, draft Guidance.

\(^4\) Paragraph 2.22, draft Guidance.

\(^5\) There is a limited exception to this in the case of Financial Institutions with a local client base which while NRUKFIs have limited reporting obligations. Annex II, Section II Paragraph 2, UK IGA.

\(^6\) Article 4.5 UK IGA.

\(^7\) Article 1.1(o) UK IGA.

\(^8\) Article 1.1(q) UK IGA.

\(^9\) Paragraph 3.1, draft Guidance.
Other entities which may be treated as deemed-compliant, exempt beneficial owners or excepted FFIs under FATCA are considered in more detail in Chapter 7 of this book.

§16.03 OBLIGATIONS IMPOSED ON RUKFIs


[a] U.S. Reportable Accounts

The obligations imposed on RUKFIs are set out in Article 4 of the U.K. IGA and translated into U.K. law by the Regulations. RUKFIs are required to identify U.S. Reportable Accounts maintained by them and annually report specific account information to HMRC.\(^{38}\)

A U.S. Reportable Account is a Financial Account that, following the application of the due diligence procedures imposed by the U.K. IGA, is identified as being held either by a Specified U.S. Person or by an entity that is not a U.S. Person but that has one or more controlling persons\(^{39}\) that is a Specified U.S. Person.\(^{40}\)

A Financial Account is any account maintained by a FI, subject to limited exclusions set out in Annex II to the IGA,\(^{41}\) and includes:

(i) any debt or equity interest (other than those regularly traded on an established securities market) in an Investment Entity, and any such debt or equity interest in any other FI if its value is determined by reference to assets giving rise to U.S. Source Withholdable Payments\(^ {42}\) and the interest was established to avoid reporting under the IGA;\(^{43}\)

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\(^{37}\) There are nine criteria to be satisfied for an Financial Institution to be considered a “Financial Institution with a Local Client Base”. See Section II, Paragraph B.2 of Annex II of the UK IGA, including that the FI cannot solicit account holders outside the UK, that at least 98% of accounts by value must be held by residents of the UK or another EU Member State, and that from January 1, 2014 the FI does not provide accounts to any Specified U.S. Person who is not a resident of the UK, a NPFL or any passive NFFE with Controlling Persons who are U.S. citizens or residents. See Annex II UK IGA; Paragraphs 2.9 and 2.28, draft Guidance.

\(^{38}\) Article 4.1(a) UK IGA.

\(^{39}\) Article 1.1(mm) UK IGA: “the natural persons who exercise control over an entity”.

\(^{40}\) Article 1.1(dd) UK IGA.

\(^{41}\) These exceptions include certain pension schemes and Individual Savings Accounts (ISAs).

\(^{42}\) Article 1(1)(jj) UK IGA: “U.S. Source Withholdable Payment” means any payment of interest (including any original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources within the United States. Notwithstanding the foregoing, a U.S. Source Withholdable Payment does not include any payment that is not treated as a withholdable payment in relevant U.S. Treasury Regulations.”

\(^{43}\) U.S. Source Withholdable Payments for these purposes, therefore includes payments of U.S. source income, not gross proceeds. For more detail on withholdable payments generally see Chapter 12 of this book.

\(^{43}\) Article 1.1(s)(1)-(2) UK IGA.
(ii) any Cash Value Insurance Contract or Annuity Contract (subject to limited exceptions);\(^{44}\)

(iii) Depositary Accounts including commercial current accounts, savings accounts, certificates representing cash placed on deposit (and similar instruments) and also pre-paid payment cards;\(^{45}\) and

(iv) Custodial Accounts, which are accounts that contain any financial instruments or contracts held for investment\(^ {46}\) for the benefit of persons other than the RUKFIs maintaining such accounts.

Specified U.S. Persons\(^ {47}\) include all U.S. citizens or resident individuals (and the estates of such persons), U.S. partnerships or corporations (other than those regularly traded on an established securities markets and corporations in the same expanded affiliated group),\(^ {48}\) as well as certain types of trust. However there are exclusions for U.S. government and federal entities, tax-exempt organisations, individual retirement plans and certain banks, trusts, dealers and brokers as defined in specified sections of the Code.\(^ {49}\)

[b] Information Requirements

The information to be obtained annually by each RUKFI and passed on to HMRC is, in the case of each U.S. Reportable Accounts it maintains:\(^ {50}\)

(i) the name, address and U.S. federal taxpayer identifying number (U.S. TIN)\(^ {51}\) of each Specified U.S. Person that is listed as an account holder or who, in the case of an account held by an entity that is not a U.S. Person, controls the holder of that account;

(ii) the account number (or equivalent, if there is no account number);\(^ {52}\)

\(^{44}\) For definitions of Cash Value Insurance Contract and Annuity Contract see above. In terms of exceptions, not included is “a noninvestment-linked, nontransferable immediate life annuity that is issued to an individual and monetizes a pension or disability benefit provided under an account, product, or arrangement identified as excluded from the definition of Financial Account in Annex II”. See Article 1.1(s)(3) UK IGA.

\(^{45}\) Article 1.1(t) UK IGA. The term “Depository Account” includes any commercial, checking, savings, time, or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar instrument maintained by a Financial Institution in the ordinary course of a banking or similar business. A Depository Account also generally includes an amount held by an insurance company under an agreement to pay or credit interest thereon. Paragraph 3.4, draft Guidance.

\(^{46}\) Article 1.1 (u) UK IGA states such investments “include a share or stock in a corporation, a note, bond, debenture, or other evidence of indebtedness, a currency or commodity transaction, a credit default swap, a swap based upon a nonfinancial index, a notional principal contract, an Insurance Contract or Annuity Contract, and any option or other derivative instrument”.

\(^{47}\) Article 1.1(ff) UK IGA, to be interpreted in accordance with the Code.

\(^{48}\) As defined by IRC §1471(e)(2).

\(^{49}\) Article 1.1(ff)-(gg) UK IGA.

\(^{50}\) Article 2.2(a) UK IGA; Regulation 10.

\(^{51}\) If a RUKFI does not have a record of an account holder’s U.S. TIN, it is required to obtain it from the account holder. See Regulation 10(8). However, note that this obligation only applies as of the calendar year 2017. Prior to 2017, a date of birth should be supplied instead if applicable and known.

\(^{52}\) Regulation 10(4)(c).
(iii) the account balance or value as of the end of the calendar year or other appropriate reporting period;\textsuperscript{53} and

(iv) the total gross credits paid to the account during the relevant reporting period.\textsuperscript{54}

The meaning of gross credits depends on the account in question:

(i) for Custodial Accounts, it refers to amounts of interest, dividends and other income generated by account assets\textsuperscript{55} and the proceeds of property sales or redemption where the RUKFI acted as agent for the account holder;

(ii) for Depositary Accounts, it is the amount of interest; and

(iii) for other accounts it is the amount paid by the FI to the account holder under a legal obligation and any redemption payments.

The RUKFI must then submit an annual return to HMRC setting out the required information together with its treaty identification number (i.e. the number allocated to it by the IRS), a statement as to whether Article 4.5 of the U.K. IGA applies and has been complied with,\textsuperscript{56} and if a RUKFI maintains no U.S. Reportable Accounts in a given calendar year, a statement to that effect.\textsuperscript{57}

[c] Due Diligence

Financial institutions are required under the draft Regulations to establish and maintain arrangements that are designed to identify reportable accounts.\textsuperscript{58} Regulation 9 and Annex I of the IGA set out the due diligence procedures and requirements for RUKFIs in identifying such accounts.\textsuperscript{59}

Different procedures are specified depending on the value of the account, whether it is held by a natural or non-natural person and whether or not it is already maintained by a RUKFI as of December 31, 2013 (i.e. whether it is a Pre-existing Account or a New Account).\textsuperscript{60} The process focuses on the identification of certain U.S. indicia linked to an account holder.

\textsuperscript{53} RUKFIs are required to specify the currency in which the amounts it reports are denominated. Article 3.2.

\textsuperscript{54} Article 2.2(a)(5)-(7) UK IGA and Regulation 10(5). Reference to “total gross credits” is in the Regulations and reflects the requirements of Article 2.2(a)(5)-(7) of the UK IGA. Reference to amounts paid shall include amounts credited. See Regulation 10(6).

\textsuperscript{55} References to a balance include a nil balance. See Regulation 10(6)(b). The amounts and nature of payments may be determined in accordance with the principles of UK tax law, Article 3.1 UK IGA.

\textsuperscript{56} Article 4.5 UK IGA is considered below and relates to the obligations of RUKFIs in respect of related entities or branches that are Nonparticipating Financial Institutions.

\textsuperscript{57} Regulation 10(2).

\textsuperscript{58} Regulation 9(1).

\textsuperscript{59} If, after application of these procedures, an account is not identified as a U.S. Reportable Account, the RUKFI which maintains that account should not be required to report on it.

\textsuperscript{60} Described as a “December 31, 2013 account” and “post-2013 account” under the Regulations.
[d] Pre-existing Individual Accounts

[i] De Minimis Accounts

RUKFIs may elect not to review, identity, or report certain Pre-existing Accounts held by individuals (Pre-existing Individual Accounts) regarded as de minimis or otherwise not required to be reported.61 Note that currently under the Regulations an election is required by the financial institutions not to report such accounts, but that this is an area being discussed by HMRC and stakeholders.62

[ii] Lower-Value Accounts63

The due diligence requirements as regards Pre-existing Individual Accounts with a balance or value as of December 31, 2013 that exceeds $50,000 (or $250,000 in the case of Cash Value Insurance Contracts and Annuity Contracts) but does not exceed $1,000,000 comprise an electronic record search for U.S. indicia, such as U.S. citizenship or residence, or standing instructions to transfer funds to an account maintained in the U.S. If no U.S. indicia are revealed by the search, no further action is required unless a change of circumstances occurs, resulting in U.S. indicia becoming associated with the account. If U.S. indicia are discovered, the account should be treated as a U.S. Reportable Account, although, depending on the indicia in question, the relevant RUKFI may elect to procure evidence that the indicia are not reflective of an actual U.S. connection, in which case the account will not be treated as a U.S. Reportable Account.

[iii] Higher-Value Accounts64

More demanding procedures apply to Pre-existing Individual Accounts with a balance or value as of December 31, 2013 (or December 31 in any subsequent year) that exceeds $1,000,000. In addition to carrying out an electronic record search as described above, a paper record search is also required if the electronic records do not contain sufficient information. The paper record search involves a review of the RUKFI's current customer file and, if inadequate, certain other documentary evidence gathered by the RUKFI within the last five years.65 Moreover, as regards such accounts, RUKFIs must treat as a U.S. Reportable Account any account assigned to a relationship manager if the relationship manager has actual knowledge that the account is held by a Specified U.S. Person. As with lower-value accounts, provided no U.S. indicia are revealed by the search, no further action is required until U.S. indicia become associated with the account as a result of a change of circumstances. In this respect a RUKFI must implement procedures to ensure that the relationship manager identifies any change of circumstances. If U.S. indicia are discovered, the account should be treated as a U.S. Reportable Account, subject to the RUKFI electing to procure evidence to the contrary.

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61 Paragraph A, Section II, Annex I UK IGA; Regulation 5(2)(a); Regulation 5(4), being accounts with a balance or value not exceeding $50,000 as of 31 December 2013, Cash Value Insurance Contracts and Annuity Contracts with a balance or value of $50,000 or less, and Cash Value Insurance Contracts and Annuity Contracts where the law or regulations of the UK prevent their sale to U.S. residents.
62 The UK IGA contemplates the election being required in order to report the accounts, but stakeholders have suggested that this may give rise to data protection issues. Paragraphs 3.64–3.66 Summary of Reponses; Regulation 5(2)(a); Regulation 5(4); Paragraph A, Section II, Annex I UK IGA.
63 Paragraph B, section II, Annex I UK IGA; Regulation 9(3)(a).
64 Section II, Annex I UK IGA; Regulation 9(3)(b).
65 Paragraph D.2, Section II, Annex I UK IGA.
[e] New Individual Accounts\textsuperscript{66}

As with Pre-existing Individual Accounts where an election is made by a RUKFI, there is no requirement\textsuperscript{67} to review, identify or report on certain \textit{de minimis} accounts, namely Depositary Accounts and Cash Value Insurance Contracts, where the balance or value of such accounts does not exceed $50,000 at the end of any calendar year or other appropriate reporting period.\textsuperscript{68}

As regards other New Individual Accounts, upon an account being opened, a RUKFI is required to obtain self-certification from the account holder that allows it to determine whether the account holder is resident in the U.S. for tax purposes and confirm the reasonableness of such self-certification.\textsuperscript{69} If the self-certification establishes that the account holder is a U.S. resident for tax purposes, the account is to be treated as a U.S. Reportable Account. If not, no further action is required unless there is a change of circumstances that causes the RUKFI to know or have reason to know that the original self-certification obtained from the account holder is incorrect or unreliable, in which case a new self-certification must be obtained or the account be treated as a U.S. Reportable Account.

[f] Pre-existing Entity Accounts\textsuperscript{70}

Where an election is made, RUKFIs are only required to review accounts with a balance in excess of $250,000 as of December 31, 2013 as well as accounts with a balance below this level but which later come to exceed $1,000,000.\textsuperscript{71} If, following review, any accounts are determined to be held by one or more Specified U.S. Persons or by non-U.S. non-FI entities (Passive NFFEs)\textsuperscript{72} that have one or more controlling persons that are U.S. citizens or residents, such accounts shall be treated as U.S. Reportable Accounts.

In order to determine whether an account is held by one or more Specified U.S. Persons, RUKFIs should review information maintained for regulatory or customer relationship purposes (including information collected as part of KYC and AML procedures) for indications that the account holder is a U.S. Person. If such indications are found, the account holder will be treated as a Specified U.S. Person (and the account as a U.S. Reportable Account), unless the RUKFI obtains self-certification, or itself reasonably determines that the account holder is not a Specified U.S. Person.

If a Non-U.S. entity is identified as a financial institution, it should be noted that payments to a Non-participating FI will still be reportable (discussed below). Identifying a financial institution requires a review of information maintained for regulatory or customer relationship purposes. Determining whether an entity is a Non-participating FI requires a self-certification by the entity, or in the case of a participating FI or registered deemed-compliant FI

\textsuperscript{66} Section III, Annex I UK IGA; Regulation 9(3)(c).
\textsuperscript{67} Regulation 5(4).
\textsuperscript{68} Paragraph A, Section III, Annex I UK IGA; Regulation 5(2)(b).
\textsuperscript{69} Regulation 9(4) provides that RUKFIs may request additional information from account holders in support of the self-certification or require specified information under the Code. This Regulation applies to all instances in Annex I where self-certification is required.
\textsuperscript{70} Section IV, Annex I UK IGA; Regulation 9(3)(d).
\textsuperscript{71} Paragraph A, Section IV, Annex I UK IGA; Regulation 5(2)(c); Regulation 5(4). As noted above, RUKFIs currently need to elect not to have to report on accounts with \textit{de minimis} balances.
\textsuperscript{72} More specifically defined at Annex I Section VI, Paragraph B.3 UK IGA.
verification of the entity’s FATCA identifying number (or in the case of an UKFI, a review of the list to be maintained by the IRS of non-compliant RUKFIs).

The procedures to identify Passive NFFEs are a little more complicated. To determine whether an account holder is a Passive NFFE, a RUKFI must obtain self-certification from the account holder as to its status, or reasonably determine the account holder’s status itself as being other than that of a Passive NFFE. RUKFIs may then generally rely on information collected as part of KYC and AML procedures to determine the controlling persons of an account holder and whether they are U.S. citizens or residents. For accounts with a balance in excess of $1,000,000 a self-certification must always be obtained from the account holder. If, following these enquiries, it is ascertained that an account holder is a Passive NFFE controlled by persons who are U.S. citizens or U.S. residents for tax purposes, the account shall be treated as a U.S. Reportable Account.

If there is a change of circumstances that causes a RUKFI to know or have reason to know that its due diligence in respect to an account has become incorrect or unreliable, the RUKFI must re-determine the status of that account as described above.

[g] New Entity Accounts

In creating a New Account, a RUKFI must make a reasonable determination of the status of the account holder. In cases where the entity is not reasonably determined to be an Active NFFE, UKFI or other FI within an IGA jurisdiction, a self-certification must also be obtained from the account holder. If it is established that the account holder is a Specified U.S. Person or a Passive NFFE that has one or more controlling persons who are U.S. citizens or U.S. residents, the account shall be treated as a U.S. Reportable Account.

73Section V, Annex I; Regulation 9(3)(e).
# Summary of Initial Due Diligence Requirements for RUKFIs

<table>
<thead>
<tr>
<th>Account Type</th>
<th>Initial Due Diligence Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-existing Lower Value (does not exceed $1,000,000)</td>
<td>Electronic record search for U.S. indicia. Depending on indicia revealed, procurement of evidence to rebut presumption of U.S. Reportable Account.</td>
</tr>
<tr>
<td>Pre-existing Higher Value (exceeds $1,000,000)</td>
<td>Electronic record search for U.S. indicia. If electronic records incomplete, paper record search. Relationship managers' actual knowledge that account holder is Specified U.S. Person conclusive.</td>
</tr>
<tr>
<td>New (post-2013)</td>
<td>Obtain self-certification from account holder as to status.</td>
</tr>
<tr>
<td>Specified U.S. Person</td>
<td>Review regulatory/customer relationship records (including KYC/AML information). If Specified U.S. Person indicated, obtain self-certification from account holder as to status.</td>
</tr>
<tr>
<td>Pre-existing FIs</td>
<td>Review regulatory/customer relationship records (including KYC/AML information) to determine whether FI. Where entity is not UKFI or Partner Jurisdiction, obtain self-certification from entity or verify entity on published IRS FI registration lists.</td>
</tr>
<tr>
<td>Passive NFFE</td>
<td>Review regulatory/customer relationship records (including KYC/AML information). For accounts with a balance in excess of $1,000,000, obtain reasonable self-certification from account holder as to status of controlling persons.</td>
</tr>
<tr>
<td>New (post-2013)</td>
<td>Make reasonable determination of the status of the account holder. In nearly all cases, obtain reasonable self-certification from account holder as to status.</td>
</tr>
</tbody>
</table>

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74 De minimis accounts (discussed above) are not included in this table on the assumption that RUKFIs will elect to not report these. The only due diligence requirement is to monitor the value/balance of such accounts provided an election is made not to report them.
[h] Timing

The first year for which RUKFIs are required to report information to HMRC is 2013 and, under the draft Regulations, reports for that year must be submitted by March 31, 2015 (the Reporting Date).\(^75\) Thereafter, the Reporting Date for each calendar year is, provisionally, May 31, of the subsequent year.\(^76\) So, for example, the Reporting Date for 2014 would be May 31, 2015.

There are some relaxations to the reporting requirements for 2013-2016. For Pre-Existing Accounts, RUKFIs are not required to report account holders' U.S. TINs if they are not aware of them, although they must include the dates of births of individual account holders instead if these are known.\(^77\) Furthermore, it is not necessary to include information in respect to gross credits until the 2015 reporting year; and there is no need to report on gross proceeds of sale for Custodial Accounts until the 2016 reporting year.\(^78\) This is illustrated in the time-line below.

\(^{75}\) Regulation 11(3).
\(^{76}\) Regulation 10(3).
\(^{77}\) Regulation 11(2); Article 3.4 UK IGA.
\(^{78}\) Regulation 11(1); Article 3.3 UK IGA. Note that the draft Regulations currently state that the relaxation in respect of gross credits is only in regards to Custodial Accounts. However, this is not reflected in the UK IGA or draft Guidance (see paragraph 9.2 draft Guidance).
[2] Payments to Non-participating Financial Institutions

For the calendar years 2015 and 2016, RUKFIs must inform HMRC of the name of, and aggregate amount of payments made to, each Non-participating Financial Institution (NPFI)\(^{79}\) to which it has made payments, regardless of whether or not the NPFI has an account with the RUKFI.\(^ {80}\)

This obligation is stated by HMRC as being a temporary alternative to the requirement to withhold on passthru payments. HMRC notes that whether or not it continues beyond 2015-2016 will need to be considered as part of discussions as to how to achieve the policy objectives of passthru withholding while removing the compliance burden and potential legal ramifications for RUKFIs.\(^ {81}\)

The obligation applies to “payments”, which do not include consideration for the provision of goods or non-financial services.\(^ {82}\) HMRC Guidance also notes that payments for use of property made in the ordinary course of business do not have to be reported.\(^ {83}\) HMRC further notes that the payments to be reported are fixed or determinable annual or periodic payments and that these do not need to have a U.S. source, but are payments that would be withholdable were they from sources within the U.S.\(^ {84}\)

The Regulations\(^ {85}\) further set out the rebuttable presumption that payments made by a RUKFI to another financial institution are assumed to be to a NPFI. This is unless at the time of the payment, as determined in accordance with the due diligence procedures noted above, either the payee is resident in the U.K. or another IGA jurisdiction and does not appear in the IRS NPFI list, or the RUKFI obtains a self-certification from the entity, or (in the case of a participating FFI or registered deemed-compliant FFI) verifies the entity on a published IRS FFI list.\(^ {86}\)

[3] Registration

A RUKFI must comply with the registration requirements applicable to FIs in IGA jurisdictions. This is an area of continuing discussion between the U.K. and U.S., as confirmed by the draft Guidance produced by HMRC in December 2012.\(^ {87}\)

\(^{79}\) As defined in FATCA Treaty Regulations. Essentially this is a non-U.S. FI that is not compliant with FATCA and not treated as compliant with FATCA under a relevant intergovernmental agreement.

\(^{80}\) Regulation 12.

\(^{81}\) Paragraph 9.3, draft Guidance.

\(^{82}\) Regulation 12(2); Article 4.1(b) UK IGA.

\(^{83}\) “Payments” are stated in the draft Guidance as not including payments for nonfinancial services, wages, office and equipment leases, software licences, transportation, freight, gambling winnings, awards, prizes, scholarships, and interest on outstanding accounts payable arising from the acquisition of nonfinancial services, goods, and other tangible property (Paragraph 9.3, draft Guidance), but including dividends, interest other than mentioned above, dividend equivalent payments with respect to which the FI acts as custodian, intermediary, or agent, and bank or broking fees (Paragraph 9.3, draft Guidance).

\(^{84}\) Paragraph 9.3, draft Guidance. This is not expressly set out in the UK IGA or Regulations.

\(^{85}\) Regulation 12(3).

\(^{86}\) Paragraph D.3.c (1);(2) of section IV of Annex I to the UK IGA.

\(^{87}\) Page 2, draft Guidance.
[4] Withholding where a Financial Institution has Elected to Assume Primary Withholding Responsibility

Where a RUKFI is acting as a qualified intermediary (a “QI”) under the Code and has elected to assume primary withholding responsibility, it should then withhold 30% of any U.S. Source Withholdable Payments made to a NPFI. 88 HMRC has indicated though that they do not expect this provision to apply to any UKFIs in practice. 89

[5] Providing Information to Immediate Payor

If a RUKFI acts as an intermediary with respect to a U.S. Source Withholdable Payment, then it must provide to any immediate payor the information required for that entity to withhold and report under FATCA. 90

[6] Special Rules Regarding Related Entities that are NPFIs

If a UKFI, which is otherwise an IGA-compliant RUKFI or NRUKFI, has a Related Entity 91 or branch that operates in a jurisdiction that prevents that entity or branch from fulfilling the requirements of IRC Section 1471, such UKFI shall regardless be treated as still being IGA-compliant, deemed-compliant, or an exempt beneficial owner (as appropriate) provided that the following requirements are met: 92

(i) The UKFI treats each Related Entity and/or branch as a separate NPFI for the purposes of the reporting and withholding requirements of the IGA;

(ii) Each Related Entity or branch identifies itself to withholding agents as an NPFI;

(iii) Each Related Entity or branch identifies its U.S. accounts and reports on them to the extent permitted under the relevant laws of its jurisdiction;

(iv) Each Related Entity or branch does not specifically solicit U.S. accounts held by persons resident outside the jurisdiction in which it is located or the accounts of other NPFIs from outside that jurisdiction; and

(v) No Related Entity or branch is used by the UKFI or any other Related Entity to circumvent their FATCA obligations or obligations under the U.K. IGA.

88 Article 4.1(d) UK IGA.
89 Paragraph 9.4, draft Guidance. This is on the basis that while there are QIs in the UK, withholding is carried out by a withholding agent as opposed to UKFIs.
90 Paragraph 9.5, draft Guidance.
91 Article 1.1(kk) UK IGA: an Entity is a “Related Entity” of another Entity “if either Entity controls the other Entity, or the two Entities are under common control. For this purpose control includes direct or indirect ownership of more than 50 percent of the vote or value in an Entity. Notwithstanding the foregoing, the United Kingdom Competent Authority may treat an Entity as not a Related Entity of another Entity if the two Entities are not members of the same expanded affiliated group as defined in section 1471(e)(2) of the U.S. Internal Revenue Code.”
92 Article 4.5 UK IGA.
This position can be compared with the position under FATCA where, subject to a grace period until January 2016, in order for a financial institution within a group to be FATCA compliant, it is necessary for its overseas branches and all other financial institutions in the group to comply as well. This may not have been possible though, for example, due to legal restrictions on reporting in certain jurisdictions, with the result that all financial institutions in the group would have been tainted and become subject to the consequences of non-compliance, notably withholding. The U.K. IGA therefore represents a considerable improvement, allowing UKFIs to obtain the benefits afforded by the IGA even if branches and Related Entities in other jurisdictions cannot comply with every requirement under FATCA.

[7] Anti-avoidance

Regulation 14 states that where there are arrangements entered into by a person and the main purpose or one of the main purposes of any of those persons in entering into those arrangements or any part of them is to avoid any of the obligations under the Regulations, then the Regulations shall apply as if the arrangements had not been entered into.

§16.04 ENFORCEMENT AND SANCTIONS

In the case of minor technical and administrative errors, either the IRS or HMRC can contact a RUKFI directly when they have reason to believe that the errors may have led to incomplete information reporting or other infringements of the IGA.\(^\text{93}\) HMRC gives the examples of corrupted or incorrectly completed data-sets\(^\text{94}\) or data provided in an incompatible format.\(^\text{95}\)

Given that this direct contact by an overseas authority is a divergence from normal exchange of information processes and powers, HMRC notes that where a RUKFI is concerned that a direct enquiry from the IRS goes beyond the quality or format of the data and potentially presents difficulties in respect of data protection obligations, it should contact the HMRC.\(^\text{96}\)

In the case of significant non-compliance, the IRS or HMRC, as appropriate, will notify the other and HMRC will apply sanctions under its domestic law to address the issue.\(^\text{97}\) The Regulations set out the following penalties in the U.K. for non-compliance.\(^\text{98}\)

\(^{93}\) Article 5.1 UK IGA.
\(^{94}\) Paragraph 3.45, HMRC Consultation Document.
\(^{95}\) Paragraph 10.1, draft Guidance.
\(^{96}\) Paragraph 10.1, draft Guidance.
\(^{97}\) Article 5.2(a) UK IGA.
\(^{98}\) Regulations 16-18.
<table>
<thead>
<tr>
<th>Breach</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Person fails to comply with any Regulation (other than Regulation 13, for which see below).</td>
<td>£300</td>
</tr>
<tr>
<td>Person provides inaccurate information in an annual account return under Regulation 10; and (i) the inaccuracy arises as a result of failure to comply with the due diligence requirements under Regulation 9 or is deliberate; (ii) the inaccuracy is known at the time of reporting and the person does not inform HMRC at that time; or (iii) the inaccuracy is discovered subsequently and the person fails to take reasonable steps to inform HMRC.</td>
<td>Not exceeding £3000</td>
</tr>
</tbody>
</table>
| In respect of payments made to NPFIs, a person is liable for each failure to report a payment, and each failure to set out a payment accurately in an annual report required under Regulation 13. | • £300 for each failure to report a payment; and  
• £300 for each failure to set out a payment accurately in the annual report, subject to a limit of £3000 in a calendar year. |

The Regulations also make provision for assessment, appeal, and enforcement of these penalties.\(^99\) RUKFIs can use third-party services to meet their obligations under the IGA, but remain responsible for ensuring these obligations are met. Furthermore, it is no defense for a RUKFI to plead it could not afford to comply with any requirements under the IGA.\(^100\)

If a RUKFI does not resolve non-compliance issues within 18 months of notification first being given, then under Article 5(2)(b) of the U.K. IGA, the U.S. shall treat it as a NPFI. Such treatment could then result in that FI being subject to FATCA withholding despite the existence of the IGA. Under the IGA, the IRS is to make available a list of entities that will be treated as NPFIs as a result of non-compliance.\(^101\)

**§16.05 EFFECT OF THE IGA**

[1] Interaction with FATCA

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\(^{99}\) Regulations 20-23.  
\(^{100}\) Article 6.3 UK IGA; Regulation 19.  
\(^{101}\) Article 5.2(b) UK IGA.
Under Article 4(1) of the U.K. IGA, RUKFIs are deemed to have complied with IRC Section 1471 provided they comply with their obligations under the IGA (and on the seemingly reasonable assumption that the U.K. then complies with its obligations to pass this information on to the U.S.). Indeed, the IGA provides that even if a RUKFI does not comply with its IGA obligations it shall still not be subject to withholding under IRC Section 1471 unless it is identified by the IRS as a NPFI in accordance with the IGA (see above).

There has been some debate in the U.K. as to the exact effect of these provisions for RUKFIs and whether they act to exempt all forms of FATCA withholding or merely “basic” U.S. source income withholding. Ultimately this is a question of U.S. law and the interpretation of the interaction of the IGA with FATCA. However, it should be noted in any event that gross proceeds and passthru withholding are to come into effect in 2017 at the earliest and there is a clear desire that alternative approaches be adopted. As expressly noted in the U.K. IGA, the U.K. and U.S. will work together to develop a “practical and effective alternative approach to achieve the policy objectives of foreign passthru payment and gross proceeds withholding”. In view of this, to the extent that withholding on such payments does come into force, it is to be expected that further guidance will be issued on the intended scope of the IGA relieving provisions.

Furthermore, under Article 4(2) of the U.K. IGA, no RUKFI shall be required to withhold tax under IRC Sections 1471 or 1472 with respect to an account held by a recalcitrant account holder, or to close such an account, provided information reporting requirements are met. It has been argued that Article 4(2) also operates to relieve NFFEs from being subject to withholding, although it is uncertain whether NFFEs will be recalcitrant account holders in all applicable instances. Again, though, this is a question of U.S. law and it remains to be seen whether it will be an issue in practice.

Under Article 4(5) of the U.K. IGA, NRUKFIs shall be treated as a deemed-compliant FFI or exempt beneficial owner for the purposes of IRC Section 1471.

[2] Impact on Transactions

In a transactional context, the developing market approach to FATCA has focused on withholding risk and the provision of information to facilitate compliance. Regarding the former, there has been much discussion as to who should take the risk if FATCA withholding does occur in a particular transaction.

In the European loan markets, for example, there has initially been a reluctance on the part of lenders and agents to take the risk of FATCA withholding. There were fundamental concerns as to whether, for reasons outside their control, U.K. financial institutions would not be

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103 Article 6.2 UK IGA.
104 As defined in IRC §1471(d)(g).
106 Article 4.5 UK IGA.
able to comply with FATCA requirements and so be subject to FATCA withholding on payments made to them. In particular, there were concerns that confidentiality issues and data protection under domestic law might prevent compliance, that the cost of compliance might be prohibitive, or that minor errors could result in non-compliance.

However, the U.K. IGA and its implementation now provides a level of comfort that, other than in the case of significant non-compliance, financial institutions should not be subject to withholding tax on payments of U.S. source income, gross proceeds, or indeed foreign passthru. As a result, there is now a stronger argument that in the U.K. withholding risk should be borne by the recipient of payments. The rationale for this is that the recipient is the sole party that has the ability to avoid the withholding tax by complying with the legal requirements set out in the U.K. Regulations.

That the recipient takes withholding risk has been the position for some time in the international markets for bonds and swaps.\footnote{On November 21, 2011, the International Swaps and Derivatives Association ("ISDA") published a rider which pushed FATCA risk on to payees. This has been followed by a Protocol in August 2012 which allows market participants to amend the tax provisions of all their ISDA Master Agreements.} The same is not true in the European loan market\footnote{In July 2012, the Loan Market Association published two suggested Riders for dealing with FATCA risk. Rider 1 involved the Borrower taking FATCA risk, by virtue of representations and undertakings that it was not and would not be an FFI and/or an express gross-up in the case of FATCA withholding actually arising. Rider 2 meanwhile involved the Lender taking risk of FATCA withholding but with a right to veto amendments that may give rise to a loss of grandfathering. Further sets of Riders have since been issued and, in light of the extension of grandfathering, the current position is that Riders 1 and 2 have been supplemented by a Rider 3 where the Lender takes FATCA withholding risk without the protection of a Lender veto.} with transactions dealt with on a case by case basis, particularly where the loans may be syndicated to, or transferred to, entities outside of an IGA jurisdiction.

Happily though, for the time being, "grandfathering" still applies. As part of the introduction of the final form FATCA Treasury Regulations, grandfathering of U.S. source withholding has been extended to January 1, 2014. This means that payments made to non-compliant FIs pursuant to transactions entered into before January 1, 2014 should be free from withholding, provided that there is no "material modification" of obligations after that date. Whether or not a market practice emerges during the course of the year though remains to be seen.

\section*{\textsection 16.06 CONCLUSIONS}

For U.K. financial institutions, the U.K. IGA goes some way to providing a route through the compliance minefield of FATCA. The IGA seeks to reduce the risk of FATCA withholding on payments by and to U.K. financial institutions, with enforcement shifted to the U.K. authorities. It provides a means to address data protection issues through the implementation of domestic legislation, and clarifies the scope of U.K. entities which are effectively exempt from FATCA. The U.K. IGA also attempts to ease the burden of due diligence and reporting by aligning the requirements with existing anti-money laundering rules. While it remains to be seen how the U.K. IGA will interact with FATCA in practice, it is hoped that the introduction of the IGA addresses some of the principal obstacles to compliance.
Nevertheless, the implications of FATCA must remain high on the agenda for U.K. financial institutions. The implementation of the U.K. IGA into domestic law brings with it a raft of due diligence and reporting requirements to be accommodated into institutions' existing systems. Given the potential complexity of the necessary categorization, this will by no means be a quick or easy task.

It is important to note that there remain significant unresolved issues. For instance, the format of reporting is still being discussed between the U.S. and the U.K., as is the process for registration. The election to exempt de minimis accounts is currently square-bracketed in the Regulations. It is not at all clear the extent to which financial groups will be able to implement consistent systems across jurisdictions, given the small number of IGAs in place. Although the necessary procedures and mechanisms need to be put in place now in order to meet the first reporting deadlines, there will be a continuing need to monitor developments and adapt processes as and when changes occur.

Given the rapidly changing global approach to FATCA it is also important that financial institutions are considering FATCA from a transactional stand-point, in terms of both the risks of withholding and the information that may need to be provided in order to comply with their own obligations.

Finally, U.K. financial institutions will need to remain flexible. The U.K. IGA represents a significant development in the U.K.’s approach to the exchange of information for tax purposes and is likely to be the first of many such agreements entered into by the Government. Indeed, since the signing of the IGA with the U.S., the intention to enter into an agreement in a similar form with the Isle of Man has been announced and the Government has stated that more will follow.¹⁰⁹ FATCA is just the tip of the iceberg and, from the perspective of financial institutions, it is clear that flexible systems and processes will be of huge benefit in this rapidly changing legal environment.

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