

FATCA: Take 2

Are You Ready to Certify FATCA Compliance?

By

Ellen Zimiles

Managing Director and Head of Global Investigations and Compliance

Richard Kando

Director and FATCA Task Force Leader

Jeffrey Locke

Director and FATCA Task Force Leader



FATCA: Take 2

Are You Ready to Certify FATCA Compliance?

TABLE OF CONTENTS

- I. Introduction..... 1
 - A. We're not just in Switzerland anymore..... 1
 - B. Practical steps FFIs can take based on Notice 2011-34..... 1
- II. Brief background of FATCA..... 2
- III. Summary of Notice 2011-34..... 3
 - A. New procedures relating to the analysis of pre-existing individual accounts..... 3
 - B. Passthru payments..... 4
 - C. Other areas addressed in Notice 2011-34..... 5
- IV. Practical steps FFIs can take based on Notice 2011-34..... 7
 - A. The analysis of pre-existing individual accounts..... 7
 - B. Passthru payments..... 10
 - C. Other steps..... 10
 - D. Comments..... 11
- V. Conclusion..... 11
- Appendices..... 12



I. INTRODUCTION

A. We're not just in Switzerland anymore

It has become clear that the focus of the Internal Revenue Service ("IRS") and Department of Justice ("DOJ"), in their efforts to combat offshore tax evasion, has moved beyond Switzerland. Specifically, individuals with accounts maintained at HSBC in India have pleaded guilty to tax fraud and there has been a request by the DOJ to serve a "John Doe" summons to allow the IRS to obtain information relating to accounts at HSBC in India. Above and beyond HSBC, the IRS announced in February 2011 a second voluntary disclosure program, which allows individuals to disclose their offshore bank accounts while paying certain civil penalties. Enforcement actions relating to tax evasion are here to stay.

One of the most powerful tools the U.S. Government will have in their arsenal to combat offshore tax evasion is the Foreign Account Tax Compliance Act ("FATCA"), which was signed into law on March 18, 2010 and generally goes into effect on January 1, 2013. Among other things, FATCA generally mandates that for a participating foreign financial institution ("FFI") to continue to remit and receive the full value of all of its transfers and conduct its worldwide operations with limited impact by FATCA, it must identify to the IRS its U.S. accounts. The penalty for non-compliance is steep: a 30% withholding tax on certain withholdable and passthru payments.¹

On April 8, 2011, in an effort to provide further guidance regarding the implementation of FATCA, the Department of the Treasury ("Treasury") and the IRS published Notice 2011-34,² which is meant to augment, and in certain parts supplement, the previous guidance provided in Notice 2010-60. The new Notice, although clarifying and simplifying select aspects of FATCA, leaves many still unanswered questions.

B. Practical steps FFIs can take based on Notice 2011-34

With the deadline for FATCA fast approaching, FFIs must start to determine what practical steps they can take now to build their FATCA compliance program and enter into an information reporting and withholding agreement with the IRS. Based on Notice 2011-34, FFIs can start developing a plan to handle the analysis of pre-existing individual accounts and passthru payments. Additionally, Notice 2011-34 may also allow

CONTACTS »

Ellen Zimiles
Navigant
212.554.2602
ellen.zimiles@navigant.com

Richard Kando
Navigant
212.554.2698
richard.kando@navigant.com

Jeffrey Locke
Navigant
212.554.2694
jeffrey.locke@navigant.com

www.navigant.com



¹ A withholdable payment is any payment of interest, 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 U.S. and any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States. Internal Revenue Code ("IRC") § 1473(1)(A). A passthru payment is defined as any withholdable payment or other payment to the extent attributable to a withholdable payment. IRC § 1471(d)(7).

² Notice 2011-34 is entitled, "Supplemental Notice to Notice 2010-60 Providing Further Guidance and Requesting Comments on Certain Priority Issues Under Chapter 4 of Subtitle A of the Code" and "... provides guidance in response to certain priority concerns identified by commentators following the publication of Notice 2010-60 and requests further comments with respect to specific issues." p. 2.

FFIs to make some determinations concerning their affiliated group and whether certain of their affiliates could meet parameters to obtain deemed compliant status.

This paper is divided into three sections: (1) a brief background of FATCA; (2) a discussion of Notice 2011-34 and (3) practical steps an FFI can start to take based on Notice 2011-34.

II. BRIEF BACKGROUND OF FATCA

On March 18, 2010, FATCA was signed into law as part of the Hiring Incentives to Restore Employment Act. FATCA generally goes into effect on January 1, 2013 and provides the Treasury and the IRS with oversight responsibility. The goal of FATCA is to combat tax evasion by mandating that FFIs report select information on their U.S. accounts to the IRS. To achieve this goal, in general, FATCA requires FFIs³ to put processes in place to identify and report their U.S. accounts to the IRS or suffer a penal withholding tax. Participating FFIs will be required to enter into an agreement with the IRS (the "FFI Agreement") to report certain information regarding their account holders and withhold on certain payments, if necessary.

To help put FATCA into a working framework, the Government has issued two Notices: (1) on August 27, 2010, the Government issued its first guidance for FATCA, Notice 2010-60 and (2) on April 8, 2011 the Government issued Notice 2011-34. The two Notices provide much needed detail to allow FFIs to start to create their FATCA compliance systems, although to have a fully operational system more guidance or proposed regulations are needed.

Notice 2010-60, among other things, outlined the procedures to be followed to identify U.S. accounts for pre-existing and new, individual and entity accounts. Notice 2011-34 outlines new procedures to be followed for pre-existing individual accounts and replaces the procedures outlined in Notice 2010-60. In attempting to identify U.S. accounts among the FFI's individual account population, there are three classifications for individual accounts that will trigger different actions by the FFI. The account can be classified as: (1) a U.S. account, which triggers a reporting requirement; (2) a non-U.S. account, which does not trigger any further reporting or withholding obligation or (3) a recalcitrant account holder,⁴ which triggers a withholding and reporting requirement.

The analysis of entity accounts is more cumbersome, but has the same main goals: identifying U.S. accounts and determining if there should be reporting and/or withholding for entity account holders.⁵

Prior to Notice 2011-34, one of the biggest open issues was how to determine the amount of withholding from recalcitrant account holders and non-participating FFIs on passthru payments. Notice 2011-34 describes the mathematical formula to determine the withholding.

All participating FFIs will have to sign an FFI Agreement with the U.S. Government.⁶ The signing of the FFI Agreement starts the clock ticking on numerous obligations of the FFIs, including trying to identify pre-existing and new U.S. accounts, compliance with due diligence and certification procedures, dealing with requests for more information and reporting requirements, which are discussed in detail in section III.C.2.

³ According to FATCA, an FFI is a foreign entity that: (1) accepts deposits in the ordinary course of a banking or similar business, (2) as a substantial portion of its business, holds financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading securities, partnership interests, commodities, or any interest in these mentioned items. IRC § 1471(d)(5).

⁴ A recalcitrant account holder is an account holder who does not comply with a request for information or a waiver from the FFI within a set period of time, usually one year. IRC § 1471(d)(6).

⁵ Under FATCA, an entity can be classified as one of the following:

- (1) Participating FFI;
- (2) Deemed compliant FFI, as described in section III.C.1;
- (3) Non-participating FFI;
- (4) Non-financial foreign entity ("NFFE");
- (5) Excepted NFFE (i.e. an NFFE that operates an active trade or business);
- (6) Excepted entity under FACTA § 1471(f) (an excepted entity according to the statute);
- (7) Recalcitrant account holder; or
- (8) U.S. account.

A U.S. Account is defined, generally, as a financial account held by a specified U.S. person or by an entity that, directly or indirectly, had one or more "substantial" U.S. owners. FATCA defines a "substantial" U.S. owner as a direct or indirect owner of: (1) more than 10% of the stock of a corporation; (2) more than 10% of the profit or capital interest in a partnership; or (3) more than 10% of the beneficial interest of a trust. Investment vehicles owned by a U.S. person must also be reported to the IRS. IRC § 1473(2) and 1473(3).

⁶ FATCA allows the Government to accept select FFIs as deemed compliant FFIs, such as certain local banks, local FFI members of participating FFI groups and certain investment vehicles that meet identified parameters, which greatly reduces the burdens of compliance for these FFIs. Deemed compliant FFIs are discussed in more detail in section III.C.1.

III. SUMMARY OF NOTICE 2011-34

Notice 2011-34 demonstrated that the Government is listening to industry comments in some areas as select procedures have been changed based on those comments.

A. New procedures relating to the analysis of pre-existing individual accounts

Notice 2011-34 published revised procedures for the identification of U.S. accounts among the FFI's population of pre-existing individual accounts.⁷ The revised procedures, which make the analysis of pre-existing private banking accounts more onerous, gives FFIs relief with regard to non-private banking accounts, such as retail banking accounts.

1. Steps to complete

In general, the first two steps that an FFI must complete are:

- a. Identify accountholders already documented as U.S. Persons for other U.S. tax purposes⁸ and
- b. From the accounts not identified as U.S. accounts in Step 1, an FFI can elect to treat any account with a calendar year-end balance or value of less than \$50,000 as a non-U.S. account.

2. Private banking accounts

Pre-existing individual accounts that meet the definition of a private banking account provided by Notice 2011-34 are to be analyzed using a newly described method-

ology.⁹ FFIs must request information from the private banking relationship manager¹⁰ regarding his or her knowledge of the account holder's U.S. status and then, if the account holder's status is still unknown, review all information associated with the account, not just electronic information, for indicia of U.S. status.¹¹ If the private banking relationship manager identifies the account as a U.S. account or if there are indicia of U.S. status present, the FFI must retrieve additional documentation from the client to determine if the account is a U.S. account. A failure to provide certain information, including a waiver of local law if required, could relegate the accountholder to be identified as recalcitrant, which triggers a reporting and withholding obligation by the FFI.

3. Other accounts including retail accounts

In a huge relief to the industry, the Government, demonstrating its willingness to take into account industry concerns, has limited the amount of work necessary to analyze pre-existing individual accounts that are not private banking accounts, such as retail accounts. For these accounts, the FFI must search its electronically searchable information for indicia of U.S. status¹² and then follow-up with the account holder to request additional information if indicia of U.S. status is identified. Notice 2011-34 limited the term electronically searchable information to information the FFI maintains in its

7 In our earlier white paper, entitled *FATCA: The Long Arm of the IRS, How Foreign Financial Institutions Should Prepare for the United States Government's Effort to Combat Offshore Tax Evasion* (December 2010), Navigant set forth a preliminary workflow for pre-existing individual accounts. Due to guidance included in Notice 2011-34, we have revised that workflow which is annexed hereto as Appendix A. The other three workflows for pre-existing entity accounts, new individual accounts and new entity accounts are annexed hereto as Appendix B, C and D respectively.

8 If the FFI chooses, even if an account is already identified as a U.S. account for other, non-FATCA U.S. tax purposes, depository accounts where each holder is a natural person and the account balance or value is less than \$50,000 as of the end of the calendar year preceding the effective date of the FFI's FFI Agreement can be classified as a non-U.S. account. Notice 2011-34, pp. 8 - 9.

9 Notice 2011-34 defines a private banking account as any account maintained or serviced by an FFI's private banking department or any account maintained or serviced as part of a private banking relationship, including any account held by an entity, nominee, or other person to the extent the account is associated with the private banking relationship with an individual client. Notice 2011-34, pp. 4 - 5. There is no account minimum to qualify as a private banking account as there is according to the USA PATRIOT Act. Section 312 of the USA PATRIOT Act defines a private banking account as an account (or accounts) that: (1) require a minimum aggregate deposit of funds or assets of not less than \$1,000,000; (2) is established on behalf of 1 or more individuals who have a direct or indirect beneficial ownership interest in the account; and (3) is assigned to, or administered by, an officer, employee, or agent of a financial institution. 31 U.S.C. § 5318(j)(4)(B).

10 Notice 2011-34 defines a private banking relationship manager as an officer or other employee of the FFI who: (1) is assigned responsibility for specific account holders on an ongoing basis; (2) advises account holders regarding their banking, investment, trust and fiduciary, estate planning or philanthropic needs; and (3) recommends, makes referrals to, or arranges for the provision of financial products, services, or other assistance by internal or external providers to meet those needs. Notice 2011-34, p. 6.

11 Indicia of U.S. status include: (1) a U.S. citizenship or a green card holder; (2) a U.S. place of birth; (3) a U.S. residence or U.S. correspondence address; (4) standing instructions to transfer funds to an account maintained in the U.S. or directions regularly received from a U.S. address; (5) an "in care of" or a "hold mail" address that is the sole address with respect to the file; or (6) a power of attorney or signatory authority granted to a person with a U.S. address. Additionally, to address some of the concerns raised by the financial services industry, the Treasury and IRS removed a non-U.S. P.O. Box address as indication of U.S. status. Notice 2011-34, p. 10.

12 The indicia of U.S. status when analyzing pre-existing individual accounts that are not private banking accounts is similar, but not exactly the same, as the indicia when analyzing the FFI's private banking accounts. Specifically, the indicia are: (1) identification of an account holder as a U.S. resident or U.S. citizen; (2) a U.S. place of birth for an account holder; (3) a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. Box); (4) standing instructions to transfer funds to an account maintained in the United States; (5) an "in care of" or a "hold mail" address that is the sole address shown in the FFI's electronically searchable information for the account holder; and (6) a power of attorney or signatory authority granted to a person with a U.S. address. Notice 2011-34, p. 14.

tax reporting files or customer master files or similar files that are stored in an electronic database that is able to be queried using programming languages. The definition specifically excludes electronic information, such as .pdf files or scanned documents, which is not in a database that could be queried.¹³

4. High value accounts

FFIs will no longer have to re-apply the new account procedures to all pre-existing individual accounts with a balance or value of \$50,000 or greater, as dictated in the previously published FATCA guidance, Notice 2010-60; instead, the new threshold for analysis is \$500,000.

For accounts with year-end values or balances of \$500,000 or greater that were not previously identified as U.S. accounts or accounts with U.S. indicia, FFIs will have to conduct a diligent review of the account files for indicia of U.S. status. When there are indicia of U.S. status present, the FFI must retrieve additional documentation from the client to determine if the account is a U.S. account or a non-U.S. account. A failure to provide certain information could relegate the account-holder to be identified as recalcitrant, which triggers a reporting and withholding obligation by the FFI.

Beginning in the third year following the effective date of the FFI Agreement, the IRS will require this analysis to be completed annually for any accounts that had a year-end account balance or value of \$500,000 or more and that were not previously analyzed or identified as U.S. Accounts.

Although there is an annual retesting requirement for high value accounts, the new steps outlined in Notice 2011-34, in effect, indicate that if an account has a year-end balance or value that is less than \$500,000 and there is no electronically searchable information, the FFI will not have to examine the account for FATCA purposes. This will benefit FFIs with a large retail base as a large percentage of retail accounts may not have to be analyzed.

5. Certification by the Chief Compliance Officer or equivalent level officer

The chief compliance officer or another equivalent-level officer of the FFI will have to certify to the IRS the analysis of its pre-existing individual accounts was completed in accordance with Notice 2011-34. The certification will also include a representation that FFI management personnel did not engage in any activity, or have any formal or informal policies and procedures in place, directing, encouraging, or assisting account holders avoid identification of the U.S. accounts as of the publication date of Notice 2011-34. The certification will further require that the FFI has written policies and procedures in place prohibiting its employees from performing such actions.

The signor of the certification required under Notice 2011-34 will likely want to be involved in setting up the FATCA compliance policies and procedures and should also necessitate vigorous testing of those procedures prior to signing the certification and submitting it to the IRS. The signor of the certification may also request others responsible for FATCA compliance sign a similar certification that the ultimate signor can rely on, at least in part. The FATCA certification requirement is similar in nature to the certification requirement regarding internal controls required by Sarbanes-Oxley. Among other things, Sarbanes-Oxley requires company management to evaluate whether internal controls over financial reporting are effective and to conclude on their effectiveness.¹⁴

Perhaps most notably, Notice 2011-34 did not ask for a member of the FFI's tax or information reporting team to certify compliance.

B. Passthru payments

Notice 2011-34 provides some much needed additional information regarding passthru payments, one of the thorniest issues raised by FATCA. The passthru payment rule is meant to encourage FFIs to enter into FFI Agreements even if the

¹³ *Id.*, pp. 14 - 15.

¹⁴ 15 U.S.C. § 7241(a)(4).

FFI does not directly hold assets that produce withholdable payments. FFIs, as feared prior to Notice 2011-34, will not have to trace passthru payments to recalcitrant account holders or non-participating FFIs. Instead, the amount of the passthru payment will be largely based on the FFI's passthru payment percentage, which is the percentage of U.S. assets to total assets. Although the mathematical methodology appears to be settled, application of the formula to passthru payments will still raise many issues for FFIs.

I. Passthru payment percentage

The passthru payment percentage is generally calculated by dividing the sum of the FFI's U.S. assets¹⁵ held on each of the last four quarterly testing dates by the sum of the FFI's total assets held on those same dates. The quarterly testing date will be either the last redemption date of the quarter (for entities that conduct redemptions at least quarterly) or the last business day of the quarter (based upon the FFI's fiscal year). Generally, in regards to the passthru payment percentage, total assets include assets on the balance sheet of the FFI and also any off-balance sheet transactions or positions to the extent provided in future guidance.¹⁶

The mathematical formula to calculate the passthru payment percentage is below:

$$\frac{\text{Sum of U.S. assets}}{\text{Sum of total assets}}$$

For example, if the sum of U.S. assets was \$40 million for the four testing dates, and the sum of total assets for those same four testing dates was \$100 million, the passthru payment percentage would be 40%, or \$40,000,000/\$100,000,000.

To provide incentive for FFIs to calculate their passthru payment percentage, an FFI that does not calculate

or publish their passthru payment percentage will be deemed to have a passthru payment percentage of 100%.¹⁷

2. Passthru payment calculation

According to Notice 2011-34, for non-custodial payments, the calculation of a passthru payment made by an FFI (payor FFI) is:¹⁸

$$\text{the amount of the payment that is a withholdable payment} + \left(\text{the amount of the payment that is not a withholdable payment multiplied by the passthru payment percentage} \right)$$

3. A passthru payment example

FATCA requires a participating FFI to deduct and withhold a tax equal to 30% of any passthru payment made to a recalcitrant account holder or non-participating FFI.¹⁹ For illustrative purposes, we will make the following assumptions:

- a. An FFI is scheduled to make a \$4,000,000 payment to a non-participating FFI;
- b. The payor's FFI's passthru payment percentage is 50%;
- c. The total withholdable payment is \$1,000,000; and
- d. The amount of the payment that is not a withholdable payment is \$3,000,000.

The amount of withholding on this \$4,000,000 payment to a non-participating FFI is \$750,000. First, multiply \$3,000,000 by 50%, which equals \$1,500,000. Next, add \$1,500,000 to \$1,000,000 for a sum of \$2,500,000. Finally, multiply \$2,500,000 by 30% for a product of \$750,000.

Presented another way, $(\$1,000,000 + (\$3,000,000 \times 50\%)) \times 30\% = \$750,000$.

¹⁵ According to Notice 2011-34, Treasury and the IRS intend to publish regulations defining a U.S. asset to include any asset to the extent that it is of a type that could give rise to a passthru payment. Also, an FFI's debt or equity interest in a domestic corporation will be treated solely as a U.S. asset. Furthermore, certain interests in or other financial accounts that are not custodial accounts held with another FFI (or "Lower Tier FFI") constitute a U.S. asset equal to the value of the interest in, or account with, the Lower Tier FFI multiplied by the Lower Tier FFI's passthru payment percentage. Notice 2011-34, pp. 24 - 25.

¹⁶ Id., p. 23.

¹⁷ Id., p. 25.

¹⁸ Id., pp. 21 - 22.

¹⁹ IRC § 1471(b)(1)(D).

C. Other areas addressed in Notice 2011-34

1. Deemed-compliant FFIs

Generally, Notice 2011-34 states that (1) certain local banks; (2) local FFI members of participating FFI groups and (3) certain investment vehicles could potentially receive deemed-compliant FFI status if certain criteria are met. The definitions of these categories identified in Notice 2011-34 appear to be very restrictive. For example, under the description of "certain local banks," two of the characteristics necessary to be deemed compliant include that all of the FFIs in the expanded affiliate group must be organized in the same country and, among other restrictions, no FFI in the expanded affiliate group maintains operations outside the country of organization.²⁰

Moreover, a deemed-compliant FFI will be required to: (1) apply for deemed-compliant status; (2) obtain an FFI identification number (FFI EIN); and (3) certify every three years to the IRS that it meets the requirements for deemed-compliant FFI status.²¹ At this time, it is unclear how the IRS will review and evaluate whether an FFI applying for deemed compliant status actually meets all of the criteria.

2. Reporting on U.S. accounts

Notice 2011-34 changes certain reporting requirements from Notice 2010-60. For example, according to Notice 2011-34, Treasury and the IRS intend to issue regulations limiting the FFI's reporting requirement for account balance to year-end account balance or value instead of the highest value over the course of the year.²² Also, instead of gross receipts and withdrawals, in general, Notice 2011-34 states that Treasury and IRS

intend to issue regulations requiring the following be reported annually:

- a. The gross amount of dividends paid or credited to the account;
- b. The gross amount of interest paid or credited to the account;
- c. Other income paid or credited to the account; and
- d. Gross proceeds from the sale or redemption of property paid or credited to the account with respect to which the FFI acted as a custodian, broker, nominee, or otherwise as an agent for the account holder.²³

Additionally, according to Notice 2011-34, an FFI can elect to have each branch report information regarding its U.S. accounts.²⁴

3. Requirements for qualified intermediaries ("QIs")

Prior to the enactment of FATCA, QIs had already taken on certain withholding and/or reporting responsibilities with respect to some of their account holders. FFIs that currently participate in the QI program will be expected to become participating FFIs or deemed compliant FFIs.

Notice 2011-34 states that the Treasury and IRS also intend to coordinate FATCA mandated reporting and withholding requirements with the requirements that presently apply to QIs.²⁵

4. Expanded affiliated groups

According to Notice 2011-34, Treasury and the IRS intend to issue regulations requiring that each FFI affiliate in an FFI Group²⁶ must be a participating FFI or a

²⁰ Notice 2011-34, pp.29 - 30.

²¹ Id., p. 29.

²² Id., p. 35.

²³ Id., p. 36.

²⁴ Id., p. 38 - 39.

²⁵ Id., p. 40.

²⁶ For FATCA, an expanded affiliate group generally means financial institutions associated with one another through ownership of 50% or more or connected through a common parent entity. IRC § 1471(e)(2). According to Notice 2011-34, each member of the same expanded affiliated group is an "FFI affiliate" and the group is identified as the "FFI Group". Notice 2011-34, p. 40.

deemed-compliant FFI and each FFI affiliate will be responsible for its own due diligence, withholding and reporting obligations and return filing requirements under its FFI Agreement. Each FFI affiliate will also be issued its own FFI-EIN, but there will be a coordinated application process.²⁷ Additionally, each FFI Group will have a Lead FFI, which will be responsible for certain coordination functions with the IRS, especially as it relates to the FFI Agreement application process.²⁸

Notice 2011-34 also allows for the designation of a Point of Contact FFI ("POC FFI"), which will be responsible for addressing issues with the IRS concerning the certifications provided by their associated FFI affiliates to maintain deemed-compliant status or concerning ongoing issues pertaining to any NFFEs in the FFI Group, among other things.²⁹

Moreover, FFIs will most likely have the option to designate a compliance FFI ("Compliance FFI"), which will have an oversight role with respect to compliance with FATCA.³⁰

5. Effective date of FFI Agreements

Finally, according to Notice 2011-34, FFI Agreements will become effective on the later of: (1) the date the FFI Agreement is executed; or (2) January 1, 2013.³¹

IV. PRACTICAL STEPS FFIs CAN TAKE BASED ON NOTICE 2011-34

FFIs, based on the guidance provided in Notice 2011-34, can start to implement more practical steps to comply with FATCA. Prior to Notice 2011-34, there were only a few practical steps that FFI could take geared toward implementation. For example, some FFIs started analyzing the impact FATCA will have on their worldwide affiliates and business lines and educating their business line person-

nel of FATCA.³² There are now additional steps that can be taken over the next three to six months, prior to proposed regulations being issued, to effectively and efficiently move toward FATCA compliance. Notice 2011-34 provides FFIs with specific guidance in certain areas to further develop their compliance programs; specifically concerning the identification of U.S. accounts among the FFI's pre-existing individual account population and passthru payments. FFIs can also start to organize their affiliated group and identify potential deemed compliant FFIs. Furthermore, FFIs can send more comments to the IRS, based on the requests for certain information in Notice 2011-34 and other open items under FACTA. Outlined below are concrete steps, based on Notice 2011-34 that FFIs can take to move toward FATCA compliance.

A. The analysis of pre-existing individual accounts

Notice 2011-34 provides new guidance regarding the identification of U.S. accounts among the pre-existing individual account population that enables FFIs to start to develop their compliance methodology. FFIs will need a two pronged process: one for FATCA-defined private banking accounts and the second for non-private banking accounts. FFIs should consider implementing certain steps below on a sample basis, possibly for a single, smaller FFI affiliate or a small group of FFI affiliates, to determine the budget and resources necessary to build a comprehensive FATCA compliance system across the world.³³

I. Determine if account values can be aggregated

Prior to analyzing any account, it is important to note that Treasury and the IRS limited the extent to which FFIs must aggregate accounts by requiring FFIs only to aggregate accounts maintained by the FFI or its affiliates that are associated due to partial or complete ownership under the FFI's existing computerized information management, accounting, tax reporting or other recordkeeping systems. This was an important change

²⁷ Id., p. 41.

²⁸ Id., pp. 41 - 42.

²⁹ Id., p. 43.

³⁰ Id., pp. 43 - 44.

³¹ Id., p. 45.

³² Navigant's sample FATCA project plan is attached hereto as Appendix E.

³³ The number of FFI affiliates chosen for the sample will likely be driven by numerous factors including the number of disparate computer systems utilized across the world by the FFI. For example, an FFI that has grown through acquisitions may want to select a larger sample of FFI affiliates as many of the computer systems and information available for review may be maintained differently from location to location or across business lines. A larger sample under this scenario would most likely provide the FFI with a greater ability to predict the resources needed to build and implement a worldwide FATCA compliance program.

because the prior requirement to aggregate accounts across the world was unworkable for most, if not all, FFIs. As a first step, FFIs should determine where aggregation would apply including if aggregation could apply across certain FFI affiliates.

2. Private banking accounts

Notice 2011-34 placed a greater emphasis on the FFI's private banking relationships and put much of the responsibility regarding the identification of private banking clients on the private banking relationship managers. Moreover, private banking relationship managers will be required to search all information, not only electronically searchable information, to determine account status.³⁴

a. Inventory private banking accounts

Because the definition of a private banking account is broad, an FFI should first inventory the number of private banking accounts it maintains. This should be a two step process: (1) determine which FFI affiliates maintain private banking accounts and (2) identify how many private banking accounts are maintained at each FFI affiliate. This is important as it will help the FFI budget time and resources for each entity to complete its analysis. Moreover, the inventorying of private banking accounts will help the FFI choose which FFI affiliate(s) to use in its sample to gauge the potential costs of the overall process.

b. Identify knowledge of private banking relationship managers

i. Number of accounts

At each FFI affiliate, a matrix could be developed to identify the private banking relationship manager and each of the private banking accounts associated with the private banking relationship manager. This could help estab-

lish "ownership" of the process by each private banking relationship manager:

ii. Knowledge of a U.S. account

Notice 2011-34 provides that the FFI has to identify all accounts for which the private banking relationship manager has actual knowledge of an account being a U.S. account. For each of the private banking accounts, an electronic questionnaire (the "private banking relationship manager questionnaire") could be filled out by the private banking relationship manager to determine if any private banking accounts are known U.S. accounts to the private banking relationship manager. Working with the FFI's information technology team could be extremely useful as the private banking relationship manager questionnaire may be able to populate automatically a prototype database (the "private banking database," discussed more below)³⁵ of accounts which require analysis for potential U.S. status.

c. The diligent review of account files

Notice 2011-34 requires a "diligent review" of paper and electronic account files and other records for each private banking account.³⁶ The private banking relationship manager should sample a number of accounts to determine the amount of time it will take to identify indicia of a U.S. account. Choosing a number of FFI affiliates for the sample could be useful since each FFI affiliate may keep its account records in a different format. If electronic files are maintained and easily searchable, it is logical to start with a search of electronic files before beginning a review of paper documents and other files, which could be extremely time consuming.

³⁴ Based upon the steps outlined in Notice 2011-34, along with the information available relating to both criminal offshore banking matters and the voluntary disclosure initiative of 2009, the IRS views private banking as an area of high risk for offshore tax evasion. This could make the analysis of private banking accounts an area of high priority in any FATCA related audit.

³⁵ The reference to the building of a new, single database is for illustrative purposes only. An FFI may be able to augment a pre-existing database of information to meet its needs, or an FFI may need to develop more than one database of information.

³⁶ It will be important for FFIs to define the term "diligent review" when updating their policies and procedures.

d. Private banking database

The results of the private banking relationship manager questionnaire and the diligent review of account files could be warehoused in the private banking database. Based upon the above sample, private banking accounts will be identified as U.S. accounts, accounts with U.S. indicia or accounts without U.S. indicia.

It is extremely important to not only properly categorize the status of accounts, but for accounts that have indicia of U.S. status, it is also important to identify which indicia was identified as that will dictate the type of documentation required to prove the account is a non-U.S. account,³⁷ if, in fact, it is a non-U.S. account.

In addition to the above, any database developed or enhanced for FATCA compliance should, at a minimum, be built with enough flexibility to catalog document requests sent to clients and any client responses. The database should also be able to identify when and if a document or information request comes due as a lack of response could change the status of an account. Additionally, because there are no proposed or final regulations relating to FATCA, the private banking database may need to change based upon the Government's future interpretation of FATCA.

3. Non-private banking accounts

FFIs should begin by taking an inventory of their non-private banking accounts and electronically searchable information to determine the resources and budget necessary to complete the analysis of pre-existing non-private banking accounts.

a. Inventory non-private banking accounts

The first step is to determine how many FFI affiliates maintain non-private banking accounts. It is again important to determine: (1) which FFI affil-

ates maintain non-private banking accounts and (2) how many non-private banking accounts are maintained at each of the FFI affiliates. Again, this information should help the FFI budget time and resources for the analysis of non-private banking accounts and could also help determine which FFI affiliate(s) should be chosen to work through the analysis to further refine the resources necessary to comply with this portion of FATCA.

b. Identification of the FFI's electronically searchable information

The term electronically searchable information is narrowly drawn to include only information that the FFI maintains in its tax reporting files or customer master files or similar files that are stored in an electronic database that is able to be queried using programming languages. Each FFI that maintains non-private banking accounts should determine what information, if any, is electronically searchable information under FATCA.

c. Search for indicia of U.S. accounts

FATCA subject matter experts should work with members of the information technology team to query the electronically searchable information for U.S. indicia.

Depending on the volume of accounts that trigger indicia of U.S. status, and the current system(s) of electronically searchable information, a new database may be needed to store information relating to the analysis for U.S. account status, or the current database(s) of electronically searchable information could be augmented to capture and warehouse the necessary information.³⁸

d. Identify accounts with year-end values or balances of \$500,000 or more

After analyzing your non-private banking accounts, a diligent review of the account files associated

³⁷ Notice 2011-34, pp 10 - 12.

³⁸ See section IV.A.2.d for certain minimum recommendations relating to the building of a warehouse of information regarding the analysis of pre-existing individual accounts.

with the account needs to be completed on all pre-existing individual accounts with a balance or value of \$500,000 or more that were not previously analyzed. Each current system that tracks account balances or values could be enhanced to include a “red flag” if the account balance or value at year end is \$500,000 or more. The “red flag” could serve as a reminder that the account will have to be analyzed or re-analyzed for FATCA purposes.

B. Passthru payments

Notice 2011-34 identifies the methodology FFI's will use to determine the value of passthru payments. FFI's can now take steps to determine how feasible this process is and whether changes to the payment or other systems may be necessary.

1. Adding members to the FATCA task force

One of the main challenges of passthru payments is the calculation of the passthru payment percentage, which is the percentage of U.S. assets to total assets. The passthru payment percentage will likely dictate additional parties from the FFI's Controller, Finance and/or Treasury functions become involved with FATCA to assist with the passthru payment percentage calculation.

2. Steps to determine the passthru payment percentage

FFI's need to conduct a review of all of their FFI affiliates to determine if they can identify their U.S. assets and non-U.S. assets in a format that can be shared with the other members of the FFI Group. It is still unclear whether there will be one passthru payment percentage for the whole FFI Group or if the passthru payment percentage will be driven by the assets of each FFI affiliate.

3. Technological enhancements

Significant technological advances will have to be made to apply the passthru payment percentage to certain payments. One such enhancement would have to relate to trying to ensure the passthru payment percentage, and requisite withholding, applies to payments only

made to non-participating FFI's and recalcitrant account holders. This could involve list matching to determine if the passthru payment percentage and withholding apply, which would be similar to the list matching completed by banks to comply with requirements dictated by the Office of Foreign Assets Control (“OFAC”).

Additionally, custodians will have to make sure that their technology can match payments to the passthru payment percentage of the original issuer FFI. This could lead to custodians using numerous different passthru payment percentages based upon the identification of the original issuer FFI.

C. Other steps

1. Deemed-compliant FFI's

Although the criteria outlined for deemed compliant status appear to be narrow in scope, as part of the FFI's inventory of affected entities, an analysis should be completed to determine if any entities within the FFI Group meet the characteristics outlined in Notice 2011-34 for deemed compliant status.

2. FFI affiliate group

The application process to become a participating FFI will require coordination by the entire FFI Group. FFI's should start considering which FFI affiliate will serve as the Lead FFI in the application process. Notice 2011-34 does not identify any parameters for identifying the FFI's Lead FFI, which appears to mean that it can be any entity within the FFI Group. The FFI Group may want to consider making the Lead FFI the parent FFI or another FFI depending on the organization of the FFI Group and where subject matter experts on FATCA reside. Another consideration for determining the Lead FFI may be determining who the FATCA certifying officer will be. Anyone certifying FATCA compliance will likely want to have significant control over the compliance process.

FFI's will most likely have the option to designate a Compliance FFI, which will have an oversight role with respect to compliance with FATCA. The Compliance FFI can represent all or select FFI affiliates. A Compli-

ance FFI can establish policies and procedures, ensure that the policies and procedures are properly implemented and report to the IRS with respect to each FFI affiliate's compliance with the policies and procedures. Deputy FATCA compliance officers may reside in each of these Compliance FFIs and may likely be asked to certify compliance for their group prior to the chief compliance officer or another equivalent level officer certifying compliance to the IRS. Additionally, as other FFIs can serve as the POC FFI and the Compliance FFI, all of the main responsibilities for compliance with FATCA do not have to sit within the same FFI Affiliate.

D. Comments

The Treasury and IRS have asked for more comments on specific issues raised in Notice 2011-34. Based upon the newest Notice, the Treasury and IRS seem to be responsive to certain industry comments and the financial services industry is having a real impact on molding aspects of FATCA. Select key areas that the Treasury and IRS asked for comments relate to:

1. The application of account identification procedures to other types of FFIs including insurance companies;³⁹
2. Potential exceptions to passthru payments that would be reasonable in light of the potential burden on participating FFIs⁴⁰ and
3. Other categories of entities that should be treated as deemed-compliant FFIs.⁴¹

Besides the specific requests for comments in Notice 2011-34, there are still outstanding issues that FFIs should consider commenting on. For example:

1. One of the three prongs for determining whether an entity meets the definition of an FFI requires an analysis as to whether the entity is "engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading securities, partnership interests, commodities, or any interest in these mentioned items."⁴² The Treasury and IRS have not yet issued guidance to further define "primarily engaged in" or what type of activity constitutes investing, reinvesting or trading and
2. The refund process for a recalcitrant account holder or non-participating FFI.

FFIs that will be affected by the above issues or others should consider sending comments to the Government, as the changes from Notice 2010-60 to Notice 2011-34 show that the Government is strongly considering industry comments.

V. CONCLUSION

Non-compliance is not a realistic option for an FFI that wants to do keep doing business with the United States; therefore, an early start to building the FFI's FATCA compliance system, along with strong policies and procedures and detailed testing of those procedures are some of the best ways to comply with FATCA and to help alleviate the concerns of the chief compliance officer or equivalent level officer certifying that accounts were analyzed in a specific manner dictated by FATCA. Although all of the information needed for FATCA compliance is not included in Notice 2011-34, there are likely many steps an FFI can take now to confidently move in the right direction.

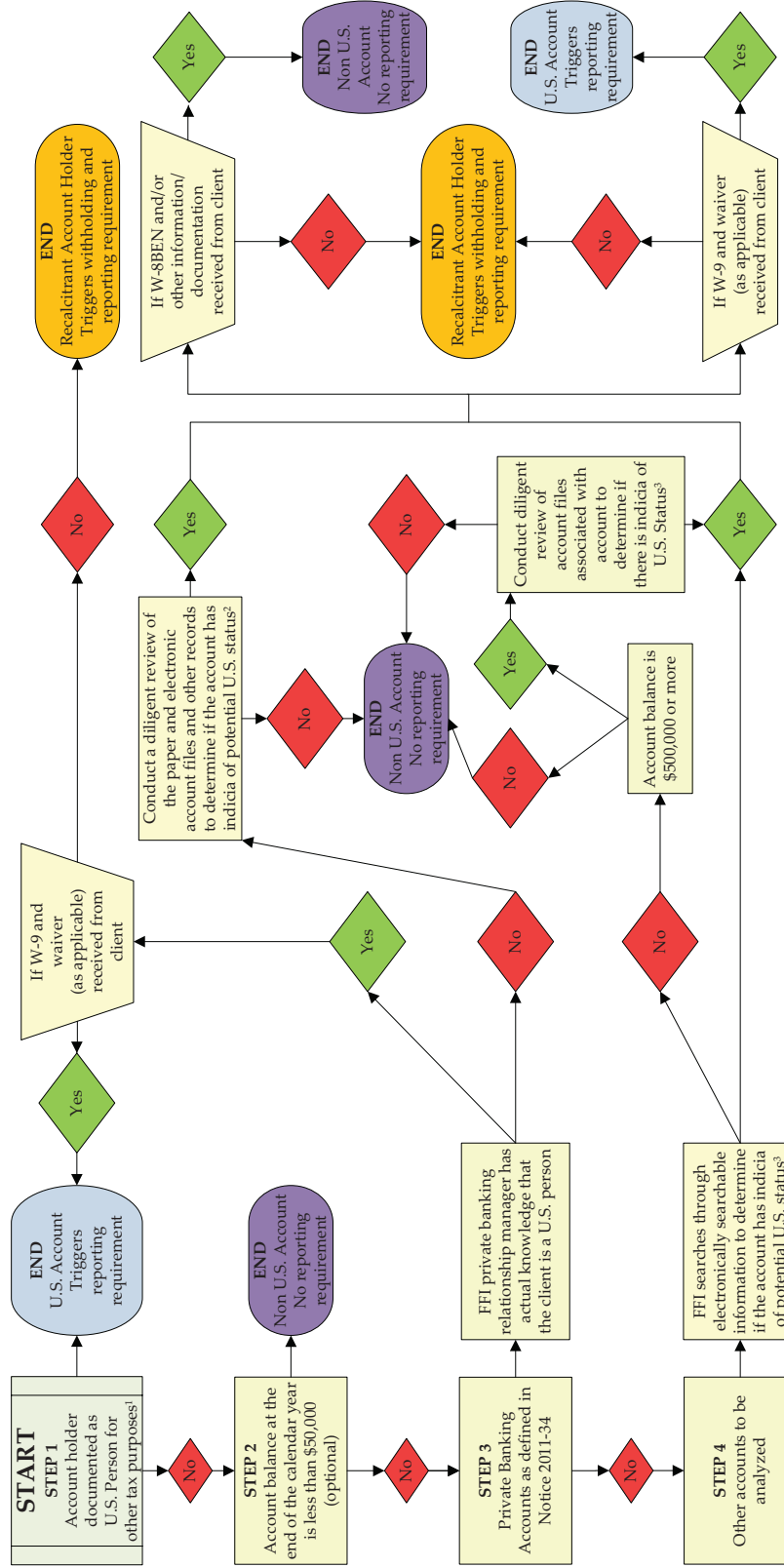
³⁹ *Id.*, p.19.

⁴⁰ *Id.*, p. 29.

⁴¹ *Id.*, p. 34.

⁴² IRC § 1471(d)(5)(C).

Appendix A
FATCA: The FFI's Revised Preliminary Workflow Concerning Pre-Existing Individual Accounts

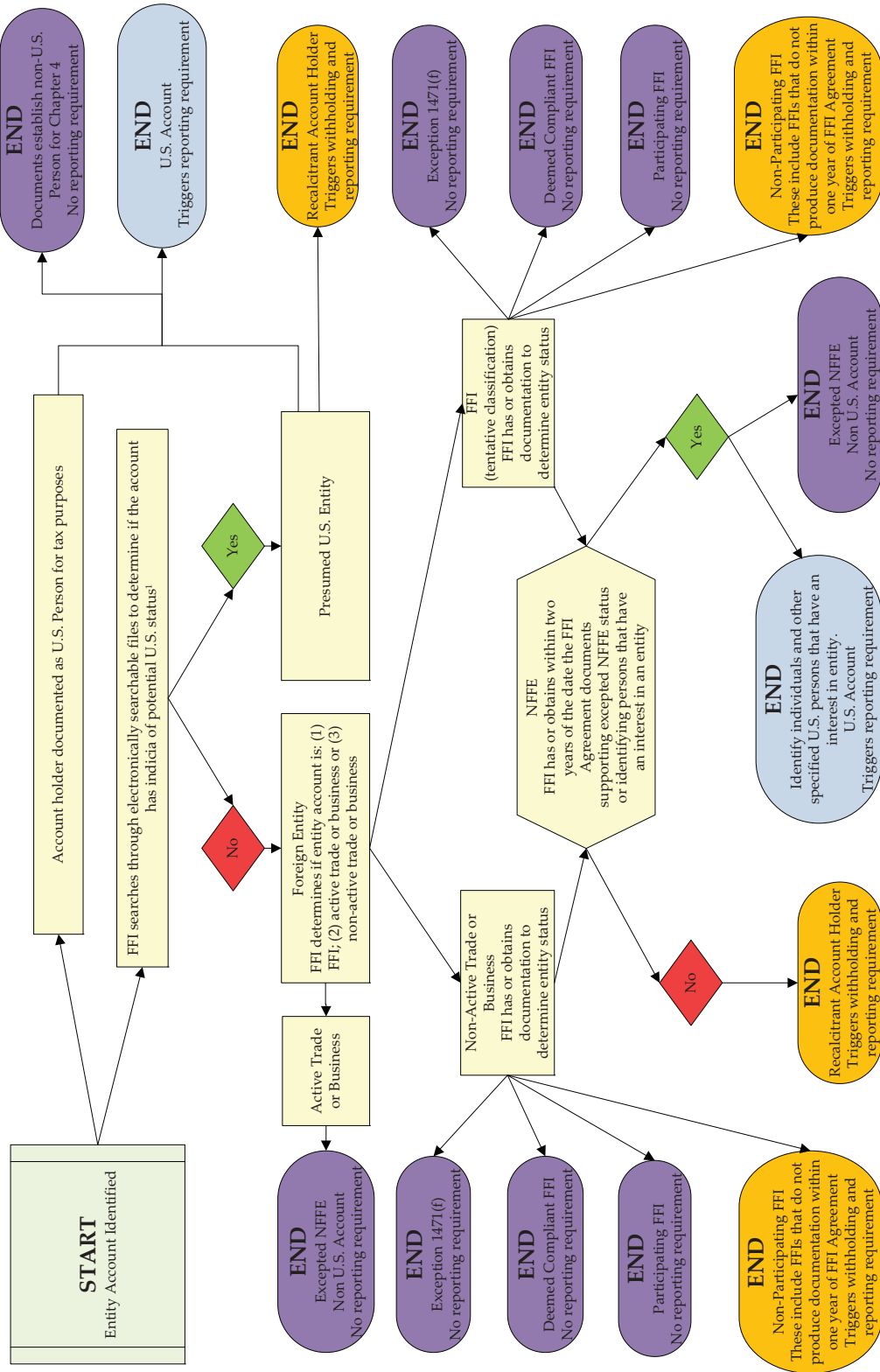


1. When an account has already been identified as a U.S. Account and its year end value is less than \$50,000, it can be classified as a non U.S. Account if it is a depository account and the accountholders are natural persons.

2. Notice 2011-34 identifies indicia of U.S. accounts under step 3 as the following: (a) U.S. citizenship or lawful permanent resident (green card) status; (b) a U.S. birthplace; (c) a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box); (d) standing instructions to transfer funds to an account maintained in the United States, or directions regularly received from a U.S. address; (e) an "in care of" address or a "hold mail" address that is the sole address with respect to the client or (f) a power of attorney or signatory authority granted to a person with a U.S. address (p. 10 of Notice 2011-34).

3. Notice 2011-34 identifies indicia of U.S. accounts under step 4 as the following: (a) identification of an account holder as a U.S. resident or U.S. citizen; (b) a U.S. place of birth for an account holder; (c) a U.S. residence address or a U.S. correspondence address (including a U.S. P.O. box); (d) standing instructions to transfer funds to an account maintained in the United States; (e) an "in care of" address or a "hold mail" address that is the sole address shown in the FFI's electronically searchable information for the account holder; or (f) a power of attorney or signatory authority granted to a person with a U.S. address (p. 14 of Notice 2011-34).

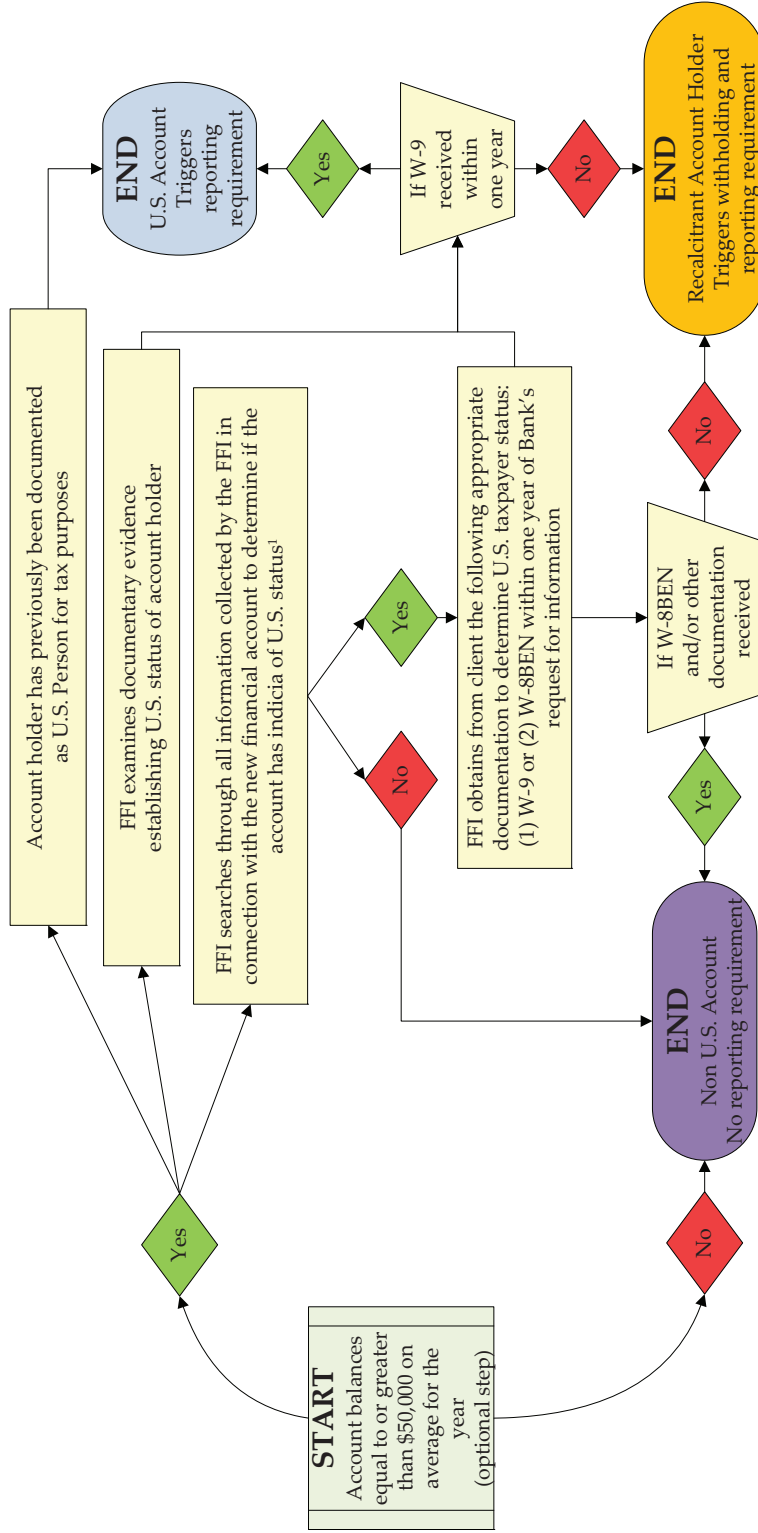
Appendix B
 FATCA: The FFI's Preliminary Workflow Concerning
 Pre-Existing Entity Accounts



1. The IRS Notice 2010-60 provides the example of an entity incorporated in the U.S. as indicia of a U.S. entity.

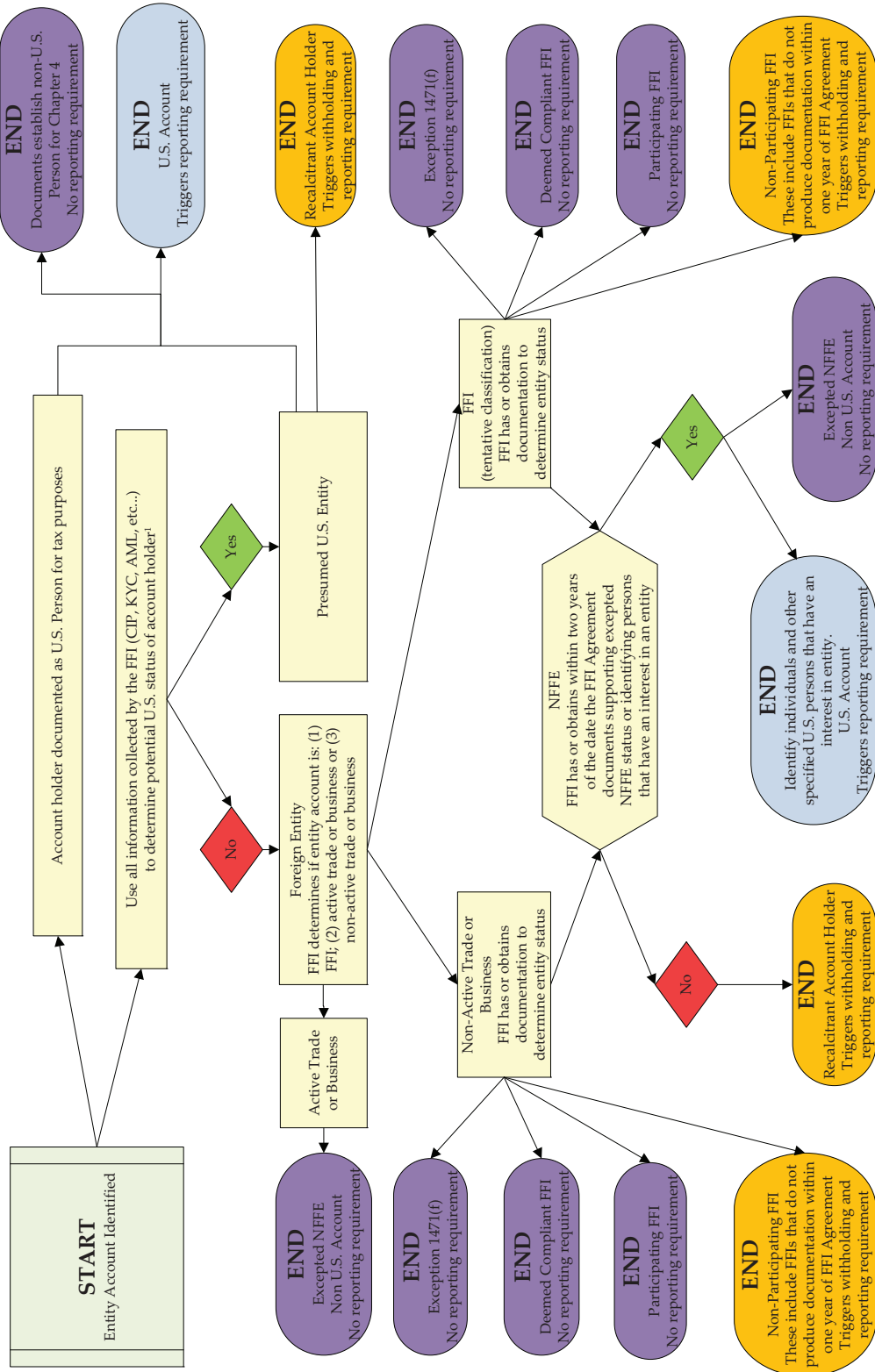
This summary document is based on Navigant's preliminary interpretation of FATCA and Notice 2010-60.

Appendix C
FATCA: The FFI's Preliminary Workflow Concerning New Individual Accounts



1. Notice 2011-34 updated the indicia of U.S. status for pre-existing individual accounts, which could lead to a change to indicia of U.S. status for new individual accounts. The indicia for new individual accounts was identified in the IRS' previous guidance, Notice 2010-60 as the following: (a) U.S. address associated with account holder; (b) U.S. place of birth identified for the account holder; (c) any other indicia of potential U.S. status, including if an account holder has only an "in care of" address, hold mail address or a P.O. Box address with respect to the account holder; (d) a power of attorney or signatory authority has been granted to a person with a U.S. address or (e) standing instructions to transfer funds to an account maintained in the U.S. or directions received from a U.S. address.

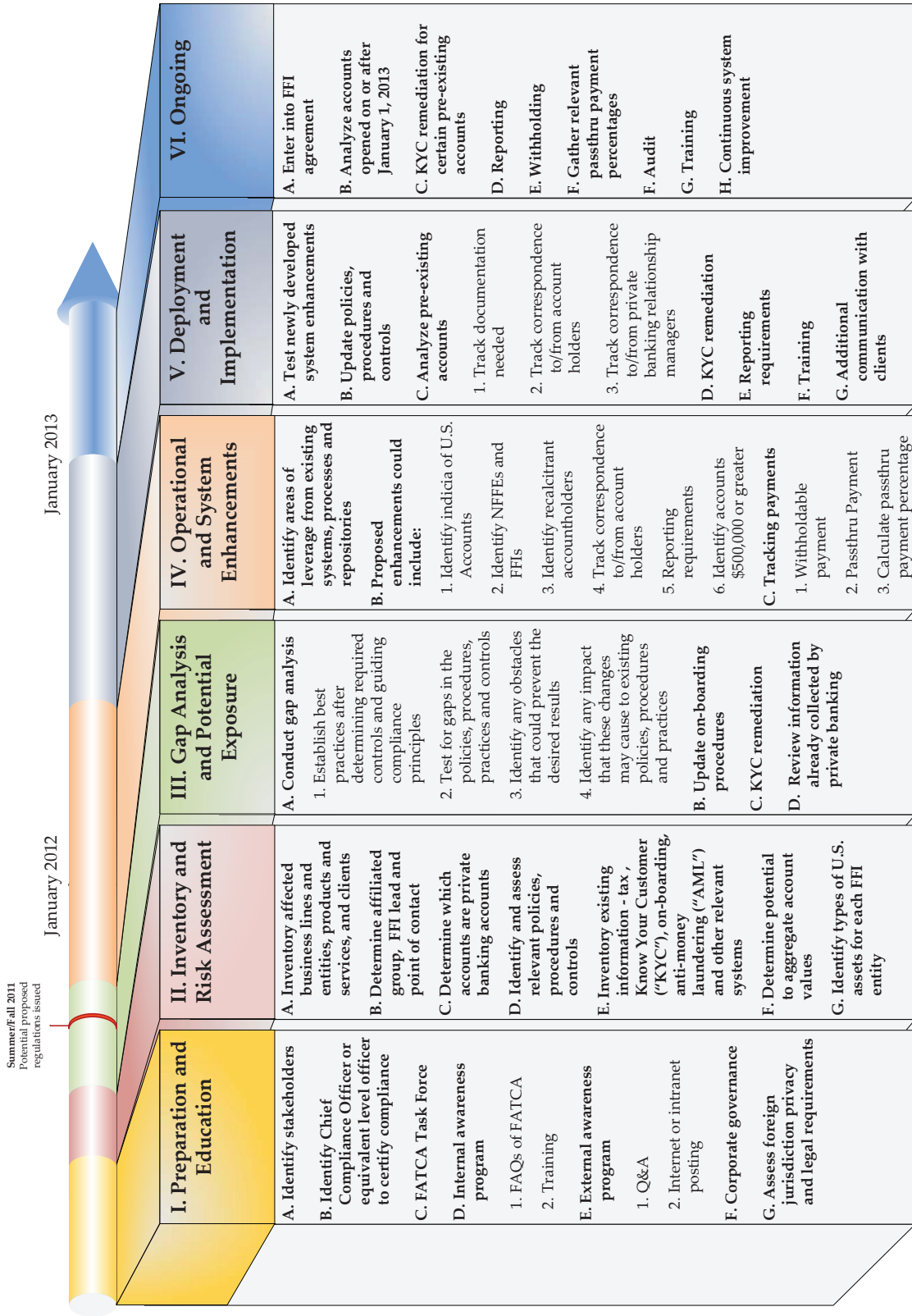
**Appendix D
FATCA: The FFI's Preliminary Workflow Concerning New
Entity Accounts**



¹ The IRS Notice 2010-60 provides the example of an entity incorporated in the U.S. as indicia of a U.S. entity.

This summary document is based on Navigant's preliminary interpretation of FATCA and Notice 2010-60.

Appendix E Sample Project Plan



The amount of time necessary to complete each of the above stages will vary by institution.

BIOGRAPHIES

Ellen Zimiles is a Managing Director and Head of Global Investigations and Compliance in Navigant's Disputes & Investigations practice. She has more than 25 years of litigation and investigation experience, including 10 years as a federal prosecutor. Ms. Zimiles is a leading authority on anti-money laundering programs, corporate governance, regulatory and corporate compliance, fraud control and public corruption matters. She has worked with a multitude of financial institutions preparing for regulatory exams, developing remediation programs and assisting organizations as a regulatory liaison. Ms. Zimiles founded and served as CEO of Daylight Forensic & Advisory LLC, an international investigations and compliance consulting firm which merged with Navigant in 2010. As an assistant United States attorney in the Southern District of New York for more than 10 years, Ms. Zimiles served in the civil and criminal divisions and was chief of the forfeiture unit for more than six years. She was responsible for many high-profile money laundering, fraud and forfeiture cases.

Richard Kando is a Director in Navigant's Disputes & Investigations practice, and along with Jeffrey Locke, a leader of Navigant's FATCA Task Force. Mr. Kando primarily assists counsel with anti-money laundering and other regulatory compliance related engagements and litigation related matters. Prior to joining the consulting industry, Mr. Kando served as a special agent for the Internal Revenue Service – Criminal Investigation Division in New York City where he investigated allegations of tax evasion and other tax related criminal offenses, mail and wire fraud, embezzlement, money laundering and identity theft. In recognition of his services as a special agent, he received the U.S. Department of Justice – Tax Division Assistant Attorney General's Special Contribution Award.

Jeffrey Locke is a Director in Navigant's Disputes & Investigations practice, and along with Richard Kando, a leader of Navigant's FATCA Task Force. Mr. Locke specializes in regulatory compliance, anti-money laundering investigations and financial investigations. Prior to joining Navigant, he was a prosecutor of white collar crime for the state of New York and he worked for the United Nations Mission in Kosovo, where he conducted investigations into war crimes, corruption and organized crime.



DISPUTES & INVESTIGATIONS • ECONOMICS • FINANCIAL ADVISORY • MANAGEMENT CONSULTING

© 2011 Navigant Consulting, Inc. All rights reserved. Navigant Consulting is not a certified public accounting firm and does not provide audit, attest, or public accounting services.
See www.navigantconsulting.com/licensing for a complete listing of private investigator licenses.