THE SMALL PRINT

Paul Foster Millen and Peter Cotorceanu detail when and why FATCA responsible officers of Model-1 IGA sponsors have IRS certification obligations

KEY POINTS

WHAT IS THE ISSUE?

Trusts and other fiduciary structures in certain Model-1 intergovernmental agreement jurisdictions (including Ireland, the Netherlands and the UK), if sponsored for the purposes of the *Foreign Account Tax Compliance Act* (FATCA), are subject to the full range of compliance duties set forth in the US FATCA Regulations.

WHAT DOES IT MEAN FOR ME?

Sponsoring responsible officers (ROs) will need to submit certifications under their own names to the Internal Revenue Service on or before 1 July 2018, affirming compliance based on FATCA policies and procedures in place, and reviewed by them.

WHAT CAN I TAKE AWAY?

Trustees and other fiduciaries sponsoring structures must act promptly to affirm that their sponsored trusts and other sponsored entities have been compliant with the full set of obligations under the US FATCA Regulations, and that they can meet the RO certification requirements.

In the preamble to the proposed revised Chapter 4, *Internal Revenue Code Regulations* (the Draft Sponsoring Regulations), adopted in December 2016, the US Internal Revenue Service (IRS) announced a surprising interpretation relevant to financial institutions (FIs) in intergovernmental agreement (IGA) jurisdictions: any entity that accessed its sponsored FI category via the US FATCA Regulations – even those in Model-1 IGA countries – assumed the registration and reporting obligations of an entity subject to the regulations.[1] This affected large numbers of deemed-compliant FIs in the so-called 'old school' Model-1 IGA jurisdictions.[2] Those older Model-1 IGAs were negotiated before the development of certain FATCA concepts, such as sponsorship. As such, the Annexes II of those IGAs omit several of the well-known deemed-compliant options, including the sponsored entity categories. Nevertheless, FIs in those countries may access the sponsored categories that were subsequently included in the US FATCA Regulations.[3] But doing so comes at a high and – pre-December 2016 – unknown cost.

UNWELCOME CONSEQUENCES

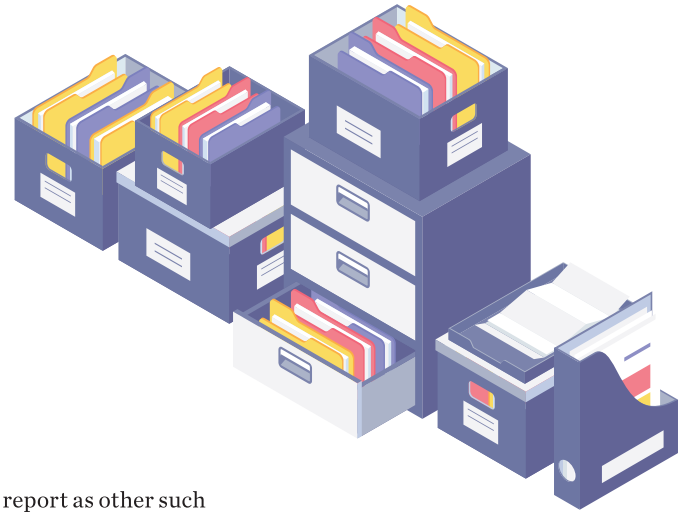
Prior to the preamble in the Draft Sponsoring Regulations, many affected parties had reasoned that, while eligibility for a category from the US FATCA Regulations should be determined per those regulations, the resulting compliance duties remained those of a Model-1 IGA FI. Not so, as it turns out. This unexpected and unforeseen construction of the rules had two immediately clear consequences:

- registration: sponsored investment entities (SIEs) in Ireland, the UK and elsewhere needed to register on the FATCA Portal, even if they had no US person account holders;[4] and
- reporting: any entities accessing an FI category via the US FATCA Regulations needed to report directly to the IRS via the IDES Portal, not to their own local authorities, as mandated under a Model-1 IGA.[5]

The unwelcome consequences of the IRS posture do not end with these two activities. Registered FIs in non-IGA and Model-2 IGA jurisdictions tend to incur one other major, and distinct, compliance burden that their brethren in Model-1 IGA jurisdictions may comfortably disregard: FATCA responsible officer (RO) certifications. On a periodic basis, the RO of a participating foreign financial institution (PFFI), or reporting Model-2 FI, must certify to the IRS the ongoing fulfilment of the FI's compliance duties under FATCA.[6] Critically, this requirement extends to sponsored entities.[7] As such, the sponsoring entity of a sponsored FI, whether an SIE or a sponsored, closely held investment vehicle (SCHIV), must assume the RO certification duty on behalf of the sponsored entity.[8]

Under the former understanding of such entities in Model-1 IGA jurisdictions, sponsors of SIEs and SCHIVs undertook no such responsibility on behalf of those entities. However, the IRS seemingly views the adoption of a US FATCA Regulation FI category by a Model-1 IGA entity as an assumption of the full range of compliance duties under the US FATCA Regulations. Therefore, sponsors of SIEs and SCHIVs that accessed their category via those regulations need to submit RO certifications on behalf of their sponsored entities.

'The person nominated as sponsor RO must fulfil all corresponding duties, knowingly assumed or not'



Further, a sponsor RO owes two certifications, both due by 1 July 2018, for most sponsoring FIs: initial and periodic. In brief,[9] the certifications cover the following requirements:

- a written sponsorship agreement with each sponsored FI;[10]
- a FATCA compliance programme for each sponsored FI that is operational[11] and was reviewed by the sponsor RO;[12]
- remedial actions in the event of any material failures[13] and any failures to withhold, deposit or report;[14]
- the completion of the mandatory due diligence on preexisting account holders;[15] and
- the absence of any aid in the avoidance of FATCA reporting or withholding.[16]

Both certifications seem to necessitate a compliance programme undergirded with written policies and procedures (in addition to the mandatory written sponsorship agreement). Further, as a prudent practice, where the RO is not directly overseeing the implementation of the FATCA compliance programme, internal controls are a necessity. Effective controls provide comfort to the RO, who has personal liability exposure to the US tax authorities for false claims, and will likely submit the RO certification under penalties of perjury.

CONCLUSION

The solution to the Model-1 IGA problem is obvious: convince the IRS of the error of its position. That, however, appears unlikely. In the aftermath of the initial publication of the Draft Sponsoring Regulations, the expectation was that the IRS would recall the preamble language, or severely curtail its scope, regarding sponsored entities in Model-1 IGA jurisdictions. Despite intensive lobbying, that did not happen. Further, at subsequent conferences, IRS representatives hardened the agency's stance, reportedly confirming its position that Model-1 IGA entities accessing FI categories via the US FATCA Regulations must register and report as other such non-IGA FIs do.

Without an IRS retraction, the next option is for the authorities in the affected jurisdictions to negotiate a total repeal or partial revision of this position with the US Treasury Department. Though the local authorities will surely be sympathetic, their scope for action is constrained. Without assent on the matter from the US, Model-1 IGA local authorities cannot issue an interpretation overruling the IRS on this point. As these entities did, in fact, rely on the US FATCA Regulations, and not their own IGA for their FATCA classification, the IRS' view of its own regulations controls.

While they wait for their local tax authorities to salvage them, the sponsor ROs of SIEs and SCHIVs face a vicious dilemma. The FI entity itself may reasonably regard the burden of compliance, with the complete set of US FATCA Regulations obligations, as onerous enough to assume the risk of non-compliance, in the hopes of protection from their local authority and from the rest of the FI herd. The RO certification obligation, however, attaches personally to the RO. The person nominated as sponsor RO, upon the sponsoring FI's registration as a sponsor, must fulfil all corresponding duties, knowingly assumed or not. Following on from the position that such sponsored entities are subject to all the provisions of the US FATCA Regulations, the IRS will thus regard any neglect of the RO certification as non-compliance, subjecting each RO to risk exposure. In this fashion, the interest or wishes of the sponsoring RO may diverge from those of the sponsoring FI.

Paramount at this stage is the development of a blueprint for affected entities in Model-1 IGA jurisdictions. As long as the IRS is unwilling, and the local authorities unable, to straighten out this unforeseen bend in the compliance path for old-school Model-1 IGA sponsored entities, the sponsoring ROs must prepare themselves to cope with the outcome. If nothing changes, then the duty remains. If the duty is not fulfilled, the consequences may be severe and the liability will be personal.

1 Prop Temp US Treas Reg Preamble at pp6–7 **2** The old-school Model-1 IGAs include Denmark, France, Germany, Italy, Ireland, Mexico, the Netherlands, Norway, Spain and the UK **3** Prop Temp US Treas Reg Preamble at p6 **4** The standard under a Model-1 IGA with the category available in its Annex II **5** It is quite likely that few sponsors, if any, of FIs in a Model-1 jurisdiction with qualifying US person account holders have reported directly to the IRS, even though they ought to have, according to the amended FATCA Regulations. Therefore, the full implication of the reporting requirement is wholesale non-compliance across the fiduciary and fund industries in affected jurisdictions, unless the IRS grants a retroactive waiver to FIs that reported locally. There is no indication that the IRS intends to grant such a waiver **6** US Treas Reg ss1.1471-4(f)(3); 1.1471-4(f)(7) **7** US Treas Reg ss1.1471-5(f)(1)(i)(F)(3); 1.1471-5T(f)(2)(iii)(D); Prop Temp US Treas Reg Preamble at p7 **8** *Ibid* **9** For a fuller description of the sponsor RO certification specifics, please refer to Paul Foster Millen and Peter Cotorceanu, 'Countdown to July', *STEP Journal*, December 2017/January 2018 (Vol 25 Iss 10), pp53–55 **10** Prop US Treas Reg s1.1471-5(j)(3)(v)(B). No hint that sponsorship agreements had to be in writing was ever given by the IRS before the December 2016 amendments to the US FATCA Regulations **11** Prop US Treas Reg s1.1471-5(j)(3)(vi)(A)(1); FFI Agreement s8.01 **12** Prop US Treas Reg s1.1471-4(j)(2); FFI Agreement s8.02 **13** Prop US Treas Reg s1.1471-5(j)(3)(vi)(A)(2) **14** Prop US Treas Reg s1.1471-5(j)(3)(vi)(A)(3) **15** Prop US Treas Reg s1.1471-5(j)(5); FFI Agreement s8.03(A) **16** *Ibid*

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