Treasury Releases Model Intergovernmental Agreement on Foreign Asset Reporting

The U.S. Department of the Treasury has issued a model intergovernmental agreement to implement the information reporting and withholding tax provisions of the Foreign Account Tax Compliance Act (FATCA). The provisions are intended to combat offshore tax evasion, and they require foreign financial institutions (FFIs) to report to the IRS information about certain financial accounts.

The upshot of the model agreement is that more FFIs will be reporting information on U.S.-held accounts in the not-so-distant future. That means U.S. taxpayers with foreign accounts must take steps to ensure compliance with their own reporting obligations.

Reporting by FFIs

FATCA requires FFIs to report to the IRS certain information about the financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Proposed regulations issued by the Treasury and the IRS in February 2012 to implement this aspect of FATCA would require FFIs to enter into an agreement with the IRS to:

- Identify U.S. accounts,
- Report certain information to the IRS regarding U.S. accounts, including:
  - The name, address and U.S. tax identification number of the account holder,
  - The account number,
  - The account balance or value (including cash value or surrender value of insurance contracts),
  - For custodial accounts, the total gross amount of interest, dividends, other income, and proceeds from sale or redemption of property,
  - For depository accounts, the total amount of interest paid or credited, and
  - Other amounts of any redemption payments made during the calendar year or other appropriate reporting period.
- Verify their compliance with their obligations under the agreement, and
- Withhold a 30% tax on certain payments related to U.S. investments and made to FFIs and account holders who won't provide the required information (known as "recalcitrant account holders").

FFIs that fail to provide the required information face significant U.S. tax penalties.

Self-reporting by taxpayers

FATCA requires certain U.S. taxpayers holding foreign financial assets with an aggregate value that exceeds $50,000 on the last day of the year, or $75,000 at any time during the year, to report certain information about those assets on Form 8938, along with their annual tax returns. These thresholds

may, however, differ for a particular taxpayer based on factors such as the taxpayer's marital status and whether he or she is living abroad.

Taxpayers must also file Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts (FBAR)", if:

- They had a financial interest in or signature authority over at least one financial account located outside of the United States, and
- The aggregate value of all foreign financial accounts exceeded $10,000 at any time during the calendar year to be reported.

As FFIs begin reporting account information, it will become increasingly likely that individual taxpayers who neglect to file Form 8938 will capture the IRS's attention. Such taxpayers could be penalized $10,000, with an additional penalty of up to $50,000 for continued failure to file after receiving IRS notification to file. A 40% penalty on any understatement of tax attributable to undisclosed foreign financial assets can also be imposed.

The model agreement

After FATCA was passed in 2010, many FFIs voiced concern that providing the required information directly to the IRS would necessarily result in violations of their local banking secrecy laws. To address this issue, the Treasury and the IRS released a joint statement with several other governments on the same day the proposed regulations were released. The statement — joined by the governments of France, Germany, Italy, Spain and the United Kingdom — outlined an intergovernmental, cross-border regulatory system based on the automatic exchange of information.

The new model agreement, which was developed in consultation with those countries, marks a critical step in implementing that system. After the agreement is adopted by a country, its FFIs won't be required to enter into separate agreements with the IRS. FFIs in countries that *don't* adopt the agreement will still be required to report the required information directly to the IRS.

Two versions

The Treasury released two versions of the model agreement: a reciprocal version and a nonreciprocal version. Both provide a framework for FFIs to report financial account information to their own taxing authorities, followed by the automatic exchange of the information under existing bilateral tax treaties or tax information exchange agreements. They also address foreign legal impediments that had been raised in connection with FATCA and simplify its implementation for FFIs.

The reciprocal version also provides that the United States will exchange information currently collected on accounts held in U.S. financial institutions by residents of the partner countries. It further includes a policy commitment to pursue and support U.S. regulations and legislation that would provide for equivalent levels of exchange.

The reciprocal version is available only to countries that have an existing income tax treaty or tax information exchange agreement with the United States — and only if the Treasury and the IRS determine that the respective country has established "robust protections and practices" to ensure the information is kept confidential and used solely for tax purposes. The latter determination will be made on a case-by-case basis.

Both versions of the agreement establish the time and manner for the exchange of information, with specific provisions regarding the increasing extent of information that must be exchanged in 2013, 2014, 2015, 2016 and later years. It also includes guidelines for determining whether an FFI has

complied with the agreement and describes enforcement actions. An appendix describes FFIs' due diligence obligations for specific kinds of accounts.

The model agreement has one notable positive consequence for some U.S. taxpayers: Any recalcitrant accounts held in countries that enter the agreement will be exempt from the 30% mandatory tax withholding.

On the horizon

The model agreement hasn't yet been finalized, but, in a joint communique accompanying the model, the five European countries endorsed it and called for a speedy adoption of bilateral agreements based on the model. However, even after signing the agreement, countries likely will need to take legislative or regulatory action to impose the provisions on their FFIs.

The six countries that contributed to the model agreement have indicated that they will work with the Organisation for Economic Co-operation and Development and other European Union countries to move toward a more global system for combating tax evasion, including common reporting and due diligence standards.

With the proposed FATCA regulations expected to be finalized this fall, the increased scrutiny of foreign accounts is fast becoming a reality at home and abroad. To ensure you're in compliance, or if you have other questions regarding FATCA, please give us a call. We can be reached at TheBottomLine@cbiztofias.com and 888.761.8835.

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