



February 15, 2012

WOCCU Short Summary of U.S. Internal Revenue Service Proposed FATCA Tax Regulations Applicable to Non-U.S. and U.S. Credit Unions

On February 8, 2012 the Internal Revenue Service (IRS), the United States tax authority that is a U.S. Treasury Department bureau, proposed a regulation that will affect many non-U.S. credit unions as well as U.S. credit unions.

The IRS proposed rule would implement the Foreign Account Tax Compliance Act (FATCA), [I.R.C. §§ 1471-1474](#), which the U.S. Congress enacted in March 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act. Congress enacted FATCA in order to make it harder for U.S. taxpayers [to avoid U.S. income taxation by placing funds in overseas accounts](#). FATCA is therefore presumed to increase U.S. tax revenue without raising tax rates. The proposed FATCA rules would regulate U.S. credit unions as well as “foreign financial institutions” (FFIs)—including non-U.S. credit unions—and would subject certain transfers that involve funds attributable to U.S. income sources (such as “gross” income—i.e. not yet taxed income—earned by a U.S. taxpayer) to a 30% “withholding” for tax compliance purposes.

The proposed regulation, if finalized as proposed, would require many non-U.S. credit unions to register with the IRS or be subject to penalties, and in some cases also require certain non-U.S. credit unions to, among other things, collect taxes on the IRS’s behalf and make regular reports about accounts held by U.S. taxpayers to the IRS or a tax or anti-money laundering (AML) authority in the credit union’s home country. U.S. credit unions would be included in the proposed rule’s definition of “withholding agent,” would be required to withhold taxes on certain transactions members make with FFIs, and would need to identify members’ accounts held by FFIs and determine those accounts’ status for tax compliance purposes using primarily AML information collected pursuant to the Bank Secrecy Act’s “know your customer” rules.

The IRS will be accepting public comments regarding the proposed rule, which can be accessed [here](#), until April 30, 2012 (this includes an executive summary beginning on page 13 of the PDF). An IRS public hearing about the proposed rule is scheduled for May 15, 2012 in Washington, DC. Additional information about the proposal can be accessed at this [link](#).

The U.S. Treasury Department has also [jointly announced](#) with the governments of France, Germany, Italy, Spain, and the United Kingdom that they have entered into intergovernmental agreements (called “tax treaties” in this summary) on the exchange of tax information for FATCA compliance, and more FATCA-related tax treaties with the United States are expected. This means that credit unions in the United Kingdom and other countries that enter into FATCA-related tax treaties with the United States would likely still

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need to register with the IRS initially but would provide any additional required information about U.S. account holders to national or provincial authorities—instead of to the IRS—likely using AML reporting procedures. It is possible that not all countries will enter into FATCA-related tax treaties with the United States, however, because Canada, China, Japan, and Switzerland have all [raised objections](#) to the U.S. law.

Below is a short summary of the FATCA proposal's key provisions that are of interest to non-U.S. credit unions as well as those that apply to U.S. credit unions. The World Council of Credit Unions (WOCCU) will be preparing a longer, comprehensive summary in the near future that will address all aspects of the 388 page proposal that affect credit unions. If you have any questions or comments regarding the proposal please contact WOCCU Chief Counsel and VP for Advocacy & Government Affairs Michael Edwards at medwards@woccu.org.

Key Provisions of the IRS FATCA Proposed Regulation for Credit Unions

- **Most Non-U.S. Credit Unions Can Comply By Registering with the IRS One Time as “Deemed Compliant” FFIs:** As proposed, most non-U.S. credit unions would be eligible to comply with FATCA under the “deemed compliant” FFI requirements if the non-U.S. credit union:
 - (1) Does not have offices outside of its home country; and
 - (2) Has at least 98% of its accounts held by residents of the home country.
- **Registered “Deemed Compliant” FFIs are Otherwise Exempt:** “Deemed compliant” FFIs will likely only need to register with IRS one time, and would not likely have to engage in periodic reporting to the IRS or home country government agencies, tax collection, or “due diligence” internal reviews and audits otherwise required by the proposed rule.
- **Effect of Failing to Register with the IRS:** If an otherwise “deemed compliant” credit union does not register with IRS, it would likely be subject to a 30% “withholding” tax on certain “withholdable payments,” as defined below—i.e. on funds that are generally attributable to U.S. income sources—when the transaction involves: (1) a U.S.-based financial institution; and/or (2) a non-U.S. FFI that has either: (a) an individual agreement with the IRS for FATCA compliance purposes; or (b) is located in a country that has entered into a FATCA-related tax treaty with the United States.



- **Online Registration Process:** The IRS registration process will be an online, electronic form that is proposed to be available starting on January 1, 2013.
- **“Withholdable Payment” Defined:** The proposed rule contains a detailed proposed definition of what generally constitutes under FATCA a “withholdable payment” attributable to U.S. income sources that can be subject to the 30% “withholding.” As proposed, a “withholdable payment” generally means U.S.-related gross proceeds, certain other classes of U.S.-sourced income, and the 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 (such as the stock of a U.S. corporation).
- **“Withholding Agent” Defined:** Non-U.S. and U.S. credit unions may be required by the proposed rule to act as “withholding agents” for the IRS and collect taxes for the agency. The proposed general definition of “withholding agent” is “any person [including credit unions], U.S. or foreign, in whatever capacity acting, that has the control, receipt, custody, disposal, or payment of a withholdable payment.”
- **Non-U.S. Credit Unions That Are Not “Deemed Compliant” FFIs:** As proposed, non-U.S. credit unions that do not meet the “deemed compliant” FFI definition outlined above—either because they have cross-border offices or have more than 2 percent of their accounts held by residents of countries other than the credit union’s home country—would:
 - 1) **IRS Registration and Reporting:** Be required to register with the IRS and also:
 - a) **FATCA-Related Tax Treaties:** If a country enters into a FATCA-related tax treaty with the United States—like France, Germany, Italy, Spain and the U.K. have done already—that country’s non-exempt credit unions could report their U.S. taxpayer account information to a home country supervisory authority instead of the IRS, likely by using existing AML reporting procedures; or
 - b) **Direct Agreement with the IRS:** The non-exempt credit union would be required to enter into a comprehensive agreement with the IRS that would involve promising to report periodically to the IRS information about U.S. taxpayer accounts (unless the accounts meet the “grandfather” exemption discussed below);
 - 2) **“Grandfathered” Accounts Exemption:** As proposed, existing accounts as of January 1, 2013 at non-exempt credit unions with balances below \$50,000 USD



would not need to be reviewed or reported and some other types of accounts would also be “grandfathered” and not be subject to periodic reporting.

- 3) **Additional Non-Exempt Credit Union Compliance Procedures:** In addition, non-exempt credit unions would need to:
- a) **Review of Individual Accounts:** Most existing accounts with balances above \$50,000 USD would need to be reviewed to determine whether the account holder has indicia of U.S. residency or citizenship, such as:
 - i. The person has identified him- or herself as a U.S. resident;
 - ii. The person has a place of birth in the United States;
 - iii. The person has a U.S. address;
 - iv. The person has a U.S. telephone number;
 - v. There are standing instructions to transfer funds to an account located in the United States;
 - vi. A power of attorney or other signatory authority granted to a person with a U.S. address; or
 - vii. A U.S. “in care of” or “hold mail” address if that is the only address that the credit unions has for the account holder;
 - b) **Due Diligence:** Engage in “due diligence” concerning U.S. taxpayers’ accounts, such as by conducting internal reviews, audits, etc. of certain types of accounts on a regular basis;
 - c) **Closing Accounts:** Close the accounts of “recalcitrant” U.S. taxpayers (i.e. those who are attempting to avoid compliance with U.S. tax laws); and
 - d) **Acting as a “Withholding Agent” and Collecting Tax for the IRS:** “Withhold” and render to the IRS 30% of certain “withholdable payments” that the credit union transfers to U.S. taxpayers’ accounts and to FFIs that have not registered with the IRS and/or FFIs that



have: (i) failed to enter into a required FATCA-related agreement with the IRS; and (ii) are not located in a country that has entered into a FATCA-related tax treaty with the United States.

- **Effect of Failure to Comply:** As proposed—like for “deemed compliant” FFIs that fail to register with the IRS, discussed above—a non-exempt credit union that fails to comply with any of the above-referenced requirements would likely be subject to the 30% “withholding” tax on “withholdable payments” that involve: (1) a U.S.-based financial institution; and/or (2) a non-U.S. FFI that has either: (a) an individual agreement with the IRS for FATCA compliance purposes; or (b) is located in a country that has entered into a FATCA-related tax treaty with the United States.
- **U.S. Credit Unions as FATCA “Withholding Agents:”** As noted above, the proposed rule defines the term “withholding agent” to include U.S.-based credit unions that are not FFIs (i.e. all federal credit unions and state-chartered credit unions in the United States). If the rule is finalized as proposed, the following requirements would apply to U.S. credit unions and other “withholding agents:”
 - **Identification of Members’ Foreign Accounts:** U.S. Credit unions would be required in general to use information collected for AML purposes under the Bank Secrecy Act’s “know your customer” rules to determine each member’s status for FATCA compliance purposes and whether the member has any “pre-existing” accounts, as defined below, held by FFIs.
 - **“Pre-Existing” versus “New” Accounts:** Different requirements will apply to an account depending upon whether the account is in existence prior to January 1, 2013 (“pre-existing accounts”) or not (“new accounts”).
 - **Reporting of Members’ Ownership of Foreign Companies:** Beginning as early as March 15, 2014, U.S. credit unions may be required to report to the IRS information about members’ status as substantial owners in “nonfinancial foreign entities,” as well as other information.
 - **Withholding:** U.S. credit unions would be required in general to withhold 30% of a member’s “foreign passthru payments” that are “withholdable payments,” as defined above, and:



- 1) Starting January 1, 2014, involve income from U.S. sources paid to “new” accounts held by FFIs that have not registered with the IRS or are otherwise not FATCA-compliant as well as on some types of “pre-existing” accounts; or
 - 2) Starting January 1, 2015, are payments of the gross proceeds of U.S. income paid to FFIs that have not registered with the IRS or are otherwise not FATCA-compliant.
- **Withholding Exemptions:** Payments falling within one of the following proposed exemptions would not be subject to withholding:
- **Lack of Knowledge or Control:** U.S. credit unions would not in general be required to withhold taxes on funds that it has no control over or custody of money or property owned by a payee or beneficial owner of a payment, or lacks knowledge of the facts giving rise to such payments.
 - **Transitional Exception to Withholding:** U.S. credit unions would not be required to withhold taxes on payments made before January 1, 2015 involving some types of FFIs that have not registered with the IRS. This exception would not apply, however, when the U.S. credit union would have reason to know that the payment is to an unregistered FFI based on, for example, IRS records (e.g., IRS databases, Forms W-8 or W-9, etc.) and/or other available information like the FFI’s North American Industry Classification System code (e.g., the code for a credit union is “NAICS 522130”) or Standard Industrial Classification Code (e.g., the code for a commercial bank that is not elsewhere classified is “SIC 6029”).
 - **Payments to FFI “Qualified Intermediaries:”** Payments to FFIs that have agreed with the IRS to be “qualified intermediaries” pursuant to Revenue Procedure 2000-12, 2000-4 I.R.B. 387, may not be subject to withholding by the U.S. credit union if the “qualified intermediary” has itself elected to serve as a “withholding agent” for the IRS.
 - **“Grandfathered Obligations:”** The proposed rule would exempt from withholding any payment involving an existing “obligation”—such as bonds, term deposits, credit facilities, certain life insurance policies, etc.—outstanding on January 1, 2013, and any gross proceeds from the disposition of such an obligation.



- **“Exempt Beneficial Owners:”** Payments involving “exempt beneficial owners”—such as non-U.S. governments, territorial U.S. governments, international organizations, foreign central banks, certain retirement funds, and some other types of organizations—would not be subject to withholding.
 - **“Deemed-Compliant” FFIs:** Payments involving “deemed-compliant” FFIs that have registered with the IRS would not be subject to withholding requirements.
 - **Payments to Financial Institutions in U.S. Territories:** Payments involving financial institutions chartered by U.S. territories under certain circumstances, such as if the territory financial institution is not primarily engaged in the business or investing, reinvesting, or trading (based on, for example, the financial institution’s charter documents or credit report).
 - **Payments to Certain Other FFIs:** Special rules would apply to payments from U.S. credit unions to certain other FFIs, such as some types of partnerships and trusts.
- **“Foreign Passthru Payment” Defined:** The proposed rule does not contain the proposed definition of “foreign passthru payment.” Rather, the rule’s preamble states that the IRS plans in the near future to rewrite its regulations on Form 1099 reporting and non-resident alien withholding and reporting in order to conform those rules to FATCA. Those with changes would be effective January 1, 2014 even though the IRS has not yet proposed them yet. It is possible that the definition of “foreign passthru payment” will be included in the IRS proposed rule on changes to the agency’s existing Form 1099 reporting and non-resident alien withholding and reporting regulations.