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LEGAL ALERT

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# FATCA G-5 Model Intergovernmental Information Sharing Agreements Released, with Substantial Benefits for Insurance Company FFIs (Including Reduced Due Diligence Burdens)

On July 26, 2012, the Treasury Department released two versions of a model intergovernmental agreement (model IGA) for government-to-government information sharing under the Foreign Account Tax Compliance Act (FATCA). One version, the reciprocal version, contains reciprocal U.S. information sharing provisions. The second non-reciprocal version does not impose any information sharing requirements on the United States. Both versions of the model IGA provide a number of substantial benefits for foreign financial institutions (FFIs) resident in a country that enters into an IGA with the United States (FATCA-partner jurisdictions), thereby demonstrating Treasury's increased understanding of the insurance business and its responsiveness to the detailed comments submitted by international insurance trade associations.

The model IGAs confirm that insurance companies that do not issue cash value life insurance contracts or annuity contracts are not FFIs, but rather are non-financial foreign entities (NFFEs). Only passive NFFEs are required to identify and report their substantial U.S. owners, if any. In this regard, the model IGA provides that an NFFE will be considered active if:

- Less than 50% of the NFFE's gross income for the preceding calendar year or other appropriate reporting period is passive income and less than 50% of the assets held by the NFFE during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income; or

- The stock of the NFFE is regularly traded on an established securities market, or the NFFE is an entity related to an entity the stock of which is traded on an established securities market.

As a result, NFFE insurance companies that are resident in a country that enters into a model IGA and that are regularly traded on an established securities market, or are related to an entity that is so traded, will be active NFFEs and therefore exempt from the IGA's due diligence and reporting requirements. However, because there is no carve-out from passive income for investment income earned on the capital or reserves of an otherwise active insurance company, insurance companies that are not regularly traded, or related to a regularly traded entity, generally will be considered passive NFFEs and will be subject to the reporting requirements of the model IGA.

For insurance companies that are FFIs, the model IGAs provide an exclusion from the definition of cash value insurance contract for life insurance contracts with a cash value of $50,000 or less, but they do not extend the exclusion to low-value annuity contracts. Excluded from the definition of a "financial account" for FATCA purposes will be IGA-identified FATCA- partner pension and savings plans. Together, these exclusions will reduce the administrative burdens and costs of insurer FFIs. A further significant provision of the model IGAs excludes from the individual pre-existing account due diligence procedures any cash value insurance contracts and annuity contracts entered into on or before December 31, 2013, where U.S. law or the law of the FATCA partner effectively prevents the sale of such contracts to U.S. residents. Finally, the model IGAs provide a solution for the expanded affiliate group (EAG) rule that requires each affiliate member to be FATCA compliant in order for any other affiliate to be treated as compliant. The

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model IGAs permit FATCA-partner FFIs to remain compliant even if there is a non-compliant affiliate member within the EAG, so long as the non-compliant affiliate meets certain requirements.
The release of the model IGAs is a significant step toward the implementation of FATCA and potentially removes the legal barriers to reporting by treaty partner FFIs where privacy and data protection laws prohibit reporting to the Internal Revenue Service (IRS). The significance of the model IGAs is underscored by a contemporaneous OECD statement welcoming this action as a step toward cross-border tax compliance and enhanced transparency.

The reciprocal version of the model IGA requires the United States to automatically exchange information it currently collects on cross-border payments to nonresidents of the United States and the information about owners of deposit interest it will begin to collect as of January 1, 2013. In addition, the United States makes a policy commitment in the reciprocal model IGA to pursue regulations and to support legislation that would permit the United States to exchange equivalent information as required under FATCA. The reciprocal IGA will be available only to a country that has in effect with the United States either an income tax treaty or a tax information exchange agreement. Moreover, the reciprocal IGA will be available only to a country that provides strong safeguards on the use of the information and that uses it only for tax purposes. Treasury and the IRS will make this determination on a case-by-case basis.

Both model IGAs provide detailed due diligence procedures that FATCA-partner FFIs must follow. Significantly, as noted above, the number of individual pre-existing accounts to which due diligence procedures apply is reduced dramatically by the new exclusions. At this point, it is not known whether the final regulations will extend such exclusions to all FFIs or whether the exclusions will be limited to FATCA partner FFIs. The due diligence procedures to be applied to entity accounts permit the use of local AML/KYC rules, which commentators had requested. The model IGAs also suspend the “recalcitrant account” rules for FATCA-partner FFIs.

Other significant provisions of the model IGAs include the following.

- Excluded from the definition of annuity contracts are annuities paid to an individual that monetize pension or disability benefits provided by an arrangement or contract that is excluded from the definition of financial account. Annuity contracts are defined as contracts providing for payments with respect to the life expectancy of an individual or individuals, as well as a contracts treated as annuities under the law of the FATCA partner.

- The cash value insurance contract definition excludes amounts payable for personal injury or sickness or indemnification of an economic loss incurred upon the occurrence of the event insured against; a premium refund due to cancellation, decrease in risk, or a correction; or a policyholder dividend based on the underwriting experience of the contract or group involved.

- The definition of account holder as applied to cash value insurance and annuity contracts maintains provisions similar to those in the proposed regulations, which apply special rules to those contracts. The account holder is the person entitled to access the cash value or to change the beneficiary. If there is no such person, then the account holder is the owner named in the contract and any person with a vested entitlement to payment. At maturity, the account holder is any person entitled to a payment under the contract.

- Detailed reporting requirements similar to those under the proposed regulations are provided with a similar phased-in timeline. For cash value insurance contracts and annuity contracts, the cash value or surrender value must be reported beginning in the year 2013. The specific reporting of

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cash value or surrender value appears to confirm what is to be reported for those accounts. The proposed regulations do not contain such specificity.

- The model IGA identifies exempt beneficial owners, deemed-compliant FFIs, and exempt products, none of which is subject to FATCA reporting.
- An FFI may rely upon public information or information known to it or self-certification of an NFFE to determine an NFFE's FATCA status. FATCA reporting is not required by an active NFFE.
- The model IGA provides specific provisions about how the FATCA partner and the United States will collaborate, and how they will distinguish between minor and administrative errors, and significant non-compliance. In the event of significant non-compliance, an FFI has 18 months to cure the non-compliance.

*If you have any questions about this Legal Alert, please feel free to contact the attorneys listed below or the Sutherland attorney with whom you regularly work.*


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