



FATCA HEADLINES

THE IMPACTS OF THE FINAL U.S. FATCA REGULATIONS AND HOW NORTHERN TRUST IS PREPARING

On January 17, 2013, the U.S. Internal Revenue Service (IRS) published final regulations implementing the Foreign Account Tax Compliance Act (FATCA), aimed at reducing offshore tax evasion. The final FATCA regulations generally follow the guidelines set forth in proposed regulations issued in February 2012, but include many changes that reflect comments on the proposed regulations submitted by industry group participants, bring the final rules in line with intergovernmental agreements (IGAs) signed to date, and incorporate some of the timeline changes announced by the IRS in October 2012.

January 2013

INTERGOVERNMENTAL AGREEMENTS

The FATCA regulations will apply broadly to any withholding agent (including Northern Trust), as well as any foreign financial institution (FFI). However, an FFI in a country that has entered into an intergovernmental agreement (IGA) based on the Model 1 IGA will be required to comply with its jurisdiction's own rules, which in some cases may vary from and override the FATCA regulations. Denmark, Ireland, Mexico, Norway, Spain and the United Kingdom have signed or initialed a Model 1 IGA with the United States; as of January 30, 2013, only the United Kingdom had issued draft regulations and guidance provisions implementing the terms of its IGA.

The U.S. Treasury and IRS continue their efforts to obtain commitments from foreign governments to enter into intergovernmental agreements to improve international tax compliance and implement FATCA.

FFIs located in jurisdictions that have entered into an IGA based on the Model 2 IGA will be permitted under local law to comply with the terms of an FFI agreement with the IRS, including reporting directly to the U.S. government. Model 2 FFIs will therefore be required to implement FATCA by following the provisions of the FATCA regulations, except to the extent expressly modified by their IGA. Switzerland has announced that it has adopted a Model 2 agreement, and Japan has also indicated its interest in adhering to this model.



Northern Trust

PRELIMINARY HIGHLIGHTS AND EXPECTED IMPACTS

The FATCA regulations include many positive changes in response to comment letters submitted by various industry groups, although the IRS and Treasury did reserve on a number of key issues and continue to solicit feedback on critical topics for financial institutions. Following are some preliminary highlights of the FATCA regulations and their expected impact. However, please note that the Northern Trust FATCA implementation team is still closely studying the FATCA regulations, their interaction with the IGAs and the draft U.K. guidance, and the implications for Northern Trust and our clients. We will be preparing more detailed communications about these new rules, including updated “Frequently Asked Questions.”

- **Modified Effective Dates.** The FATCA regulations reflect the extended, phased-in timeline originally set forth in the IRS’s October 2012 timeline, and provide new information on key effective dates for FATCA implementation. The timeline below provides a summary of many of these dates, including:
 - FFIs required to register are expected to be able to register beginning **July 15, 2013**, and must complete registration by **October 25, 2013**, to avoid withholding as of January 1, 2014.
 - The IRS is expected to publish an initial list of participating FFIs (PFFIs) and registered deemed-compliant FFIs on **December 2, 2013**.
 - The effective date for new account opening procedures is **January 1, 2014**.
 - **Grandfathering provisions** for certain securities and obligations have been extended to January 1, 2014.
 - FATCA withholding on U.S.-source fixed, determinable, annual or periodical (FDAP) income begins **January 1, 2014**, for new accounts and certain pre-existing accounts identified as recalcitrant or nonparticipating FFIs (NPFIs), with later effective dates for additional categories of payees.
 - Withholding on gross proceeds and passthru payments is deferred until **January 1, 2017**, at the earliest.
- **The FATCA Regulations Provide Additional Flexibility on Documentation Requirements for Account Holders and Payees.** While some of these modifications of the documentation requirements are useful, other changes may be difficult to apply in practice. As was the case under previous guidance, different documentation requirements apply under the FATCA regulations depending on whether the account is an onshore or offshore account, whether the account is a pre-existing or new account, and the type of payee or account holder. We are currently conducting an in-depth review of the documentation and due diligence procedures under the FATCA regulations, and will be providing you our updated, detailed materials on these rules.
- **FFI Registration and Global Intermediary Identification Numbers (GIINs).** The FATCA regulations indicate that PFFIs and registered deemed-compliant FFIs (including FFIs that are considered “reporting Model 1 FFIs”) will register with the IRS using a secure online “FATCA Portal,” and will be issued a GIIN beginning no later than October 15, 2013. FFIs will use their GIINs to establish their FATCA status for withholding purposes and for reporting. However, many details of the registration process, in particular for IGA FFIs, remain unclear.

Northern Trust’s FATCA implementation team continues to study the final regulations and the implications for our clients.

The IRS plans to have the FFI registration portal available this summer and expects to begin posting a list of compliant FFIs in December 2013.

- **New Concept of “Sponsored” and “Sponsoring” FIs.** Under the FATCA regulations, a “sponsoring entity” can undertake the FATCA obligations on behalf of a “sponsored investment entity” or on behalf of a “sponsored controlled foreign corporation” if the sponsoring entity:

1. Is authorized to manage the FFI and enter into contracts on behalf of the FFI (such as a fund manager, trustee, corporate director, or managing partner);
2. Registers with the IRS as a sponsoring entity;
3. Registers the sponsored FFIs with the IRS; and
4. Agrees to perform all of the due diligence, withholding, reporting and other FATCA requirements that would have been required of the FFI.

Sponsored FFIs will be treated as registered deemed-compliant FFIs under the FATCA regulations.

- **FATCA Compliance and Responsible Officers.** In general, the FATCA regulations require each PFFI to appoint a “responsible officer” to oversee its FATCA compliance and establish a compliance program that includes policies, procedures and processes sufficient for the FFI to comply with the FFI agreement. The responsible officer is required to make periodic certifications that he or she has established a compliance program and is maintaining effective internal controls. The FATCA regulations also resurrect from early IRS guidance the concept of a “consolidated compliance program,” whereby a PFFI, reporting Model I FFI or U.S. financial institution may agree to establish and maintain a consolidated FATCA compliance program on behalf of one or more FFIs within an affiliated group.
- **Changes to the Definition of “Financial Institution.”** The FATCA regulations conform the definition of “financial institution” more closely to that set forth in the IGAs; the final definition is “a depository institution; custodial institution; investment entity; an insurance company or holding company of an expanded affiliated group that includes an insurance company; or a holding company or treasury center of an expanded affiliated group that includes a depository institution, custodian institution, insurance company or investment entity.” The term “investment entity” includes entities primarily engaged in investing and reinvesting or trading in financial assets *only if they are professionally managed by a bank, custodial institution, insurance company, or an investment entity that is a professional investment advisor.* Consequently, passive investment entities, such as trusts, will be considered “non-financial foreign entities” (NFFE) instead of FFIs, unless they are professionally managed. For investment entities like trusts that are professionally managed, the FATCA regulations indicate that the manager, which is an FFI, will manage the trust’s FATCA compliance. As a result, investment managers, fund sponsors and professional trustees classified as investment entities under the modified definition in the final rules may be required to register as FFIs.
- **Definition of “Substantial U.S. Owner” Retained From Proposed Regulations.** The FATCA regulations retain from prior guidance the general 10% ownership threshold for a “specified U.S. person” to be considered a “substantial U.S. owner” of an NFFE. The FATCA regulations do not adopt the more generous threshold found in the IGAs, which is based on the Financial Action Task Force “controlling person” definition (and is often 25%).

FATCA will have a major impact on financial institutions worldwide as these firms will be required to perform enhanced due diligence on customer accounts and make modifications to their existing systems, operations and processes. Deadlines for FATCA implementation remain challenging.

- **Some Expansion of “Deemed Compliant FFI” and “Exempt Beneficial Owner” Categories.** While the FATCA regulations provide some helpful modifications of the definition of FFIs that are “deemed compliant,” broad new carve outs were not announced. Rather, the preamble indicates that the IGAs will be relied on to identify entities that should qualify for deemed compliant status on a jurisdiction-specific basis, and eligibility for the deemed compliant categories continues to be limited. The FATCA regulations do expand the categories of “exempt beneficial owners” to which FATCA withholding does not apply, in particular the categories for pension and retirement funds.
- **Grandfathering of Certain Obligations Extended.** Payments related to certain obligations (primarily debt obligations), including derivatives transactions entered into under an ISDA Master Agreement, that are outstanding on or before January 1, 2014, will be excluded from FATCA withholding. (The proposed regulations grandfathered certain obligations outstanding on January 1, 2013.) Grandfathering also extends to any agreement requiring collateral to be posted to secure a grandfathered obligation. Under the FATCA regulations, withholding agents may rely on a written statement from the issuer of an obligation as to whether the obligation is grandfathered or whether a “material modification” has occurred such that grandfathering no longer applies. The FATCA regulations also provide that, with respect to foreign passthru payments and dividend equivalent payments, obligations will be grandfathered if they are executed on or before the date that is six months after the date on which final regulations concerning such obligations are issued.
- **Withholding on Gross Proceeds Reserved.** While the FATCA regulations provide that withholding on gross proceeds may begin January 1, 2017, at the earliest, the IRS and U.S. Department of Treasury (Treasury) have reserved on these rules. Accordingly, it remains to be seen what requirements will apply for gross proceeds withholding.
- **Guidance Still Needed.** The preamble to the FATCA regulations indicates that guidance is forthcoming in several key areas and invites feedback on certain issues. As such, we can expect guidance on qualified intermediaries (QIs); revised Forms W-8; introduction of the FFI Agreement and the FATCA Portal; and coordination of the FATCA rules with other existing withholding rules. Clarification on these issues is needed to fully understand the FATCA compliance requirements for financial institutions.

The FATCA regulations and the terms of IGAs will have major impacts on financial institutions worldwide. Although many of the timelines have been extended, deadlines for FATCA implementation remain challenging. Northern Trust’s cross-disciplinary team is identifying our legal responsibilities under FATCA and the IGAs, and is exploring how we can help our clients meet their own FATCA compliance objectives. This initiative includes:

- Conducting current and future state assessments and identifying required enhancements
 - Evaluate FATCA’s impact on Northern Trust legal entities
 - Evaluate FATCA’s impact on Northern Trust business lines

- Organizing work streams in the following areas:
 - Banking
 - Designing systems and operations to comply with Northern Trust’s due diligence, withholding and reporting requirements
 - Custody
 - Designing systems and operations to comply with Northern Trust’s due diligence, withholding and reporting requirements
 - Transfer Agency/Administration
 - Designing systems and operations to assist investment managers who choose to delegate FATCA operations (due diligence, withholding and reporting) to Northern Trust as transfer agent or administrator
 - Legal, Fiduciary and Compliance
 1. Interpreting FATCA regulations and other guidance, as required
 2. Setting FATCA policy and governance to maintain consistency in global compliance
 3. Evaluating Northern Trust legal and fiduciary obligations under FATCA
 4. Completing FFI agreement and registration requirements as required for Northern Trust legal entities
 - Communications
 1. Communicating the impacts of FATCA across Northern Trust business units
 2. Communicating the impacts of FATCA to clients
- Participating in industry initiatives to find workable solutions
 - Responding to the IRS’s and Treasury’s request for comments on the proposed guidance, individually and in conjunction with industry organizations
 - Holding joint meetings with other global custodians, the IRS and Treasury regarding rules and regulations they are drafting to implement the law
 - Participating with industry groups to frame workable solutions

As a U.S. custodian holding U.S. securities, Northern Trust will have an obligation to withhold 30% on all U.S.-sourced income and gross proceeds (withholdable payments) paid to any legal entity that is not FATCA-compliant. We are identifying transactions that qualify as withholdable payments and planning the requisite changes to our withholding systems and operations. We anticipate that other custodians will need to make similar changes.

As a fund services provider, we anticipate that fund manager clients will choose to delegate some FATCA compliance functions to Northern Trust when we maintain the investor record, including performing due diligence on all investors listed in the investor record, reporting on U.S. individuals and institutions investing in the fund, and withholding on passthru payments made to noncompliant investors. We are analyzing the required changes to our systems and operations to support these functions.

If you have any questions, regarding FATCA, including Northern Trust’s obligations, your own responsibility under FATCA, or what you should be doing to prepare for FATCA, please contact your Northern Trust relationship manager.

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Foreign financial institutions should engage their own tax and legal advisors regarding the applicability of FATCA to their individual facts and circumstances and their potential obligations under the FATCA rules.

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