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## World Council's Short Summary of the U.S. Internal Revenue Service's FATCA Final Regulation Applicable to Non-U.S. and U.S. Credit Unions

The Internal Revenue Service (IRS), the United States tax authority that is a U.S. Treasury Department bureau, issued its [544 page final regulation](#) to implement the Foreign Account Tax Compliance Act (FATCA) on January 17, 2013. FATCA purports to apply to non-U.S. credit unions as well as to U.S. credit unions which make overseas transfers of untaxed proceeds from U.S. sourced interest and investment income.

You can access World Council's detailed summary of the IRS's proposed FATCA regulation issued in February 2012 [here](#). World Council plans to issue a comprehensive *FATCA Compliance Guide* for member credit union systems this spring which will provide additional details and compliance information. If you have any questions regarding the IRS's FATCA final rule please contact Chief Counsel and VP for Advocacy & Government Affairs Michael Edwards at [medwards@woccu.org](mailto:medwards@woccu.org).

### Key Points for Credit Unions:

- **Many Improvements in Final Rule:** The IRS's FATCA final regulation makes numerous changes intended to reduce regulatory burdens on small and medium financial institutions and adopt a risk-based approach. These changes include clarifying that credit unions and similar credit cooperatives fall within the definition of partially-FATCA-exempt "non-registering local banks," allowing non-U.S. credit unions to list U.S. dollar denominated accounts on their websites without losing FATCA-exempt status, streamlining FATCA registrations and recordkeeping requirements, and delaying compliance dates. World Council recommended many of these changes in its [comment letter](#) and [public hearing comments](#) made in response to the IRS's proposed FATCA regulation last year.
- **IRS Rule Will Not Apply to Non-U.S. CUs in Jurisdictions with Most FATCA Intergovernmental Agreements:** Non-U.S. credit unions in most jurisdictions which will enter into FATCA Intergovernmental Agreements (IGAs) with the U.S. Treasury will **not** be subject to this IRS FATCA regulation. Some jurisdictions – such as Great Britain, Ireland, and Mexico – have entered into FATCA IGAs with the U.S. Treasury, and other jurisdictions are also expected to enter into FATCA IGAs in the near future.
- **Most Non-U.S. CUs Subject to this IRS FATCA Rule will be Partially Exempt:** Most non-U.S. credit unions subject to this IRS FATCA rule will fall into one of the rule's two partial exemptions for localized foreign financial institutions (FFIs). Non-U.S. credit unions with less than US\$ 175 million in assets will generally qualify as "non-registering local banks" which are not be required to register with the IRS. Larger credit unions which have localized operations would be expected to register by the end of 2103 with the IRS using a secure online system, but would be exempt from most other aspects of FATCA compliance.
- **U.S. Credit Unions:** U.S. credit unions will be required eventually to perform due diligence and tax withholding regarding overseas payments of not-yet-taxed U.S. sourced "passive" interest and

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investment income, including interest and dividends paid on credit union share accounts, and the taxable proceeds from sales of real property or other U.S.-based investments. U.S. credit unions beginning January 1, 2017 would be required to withhold 30% of payments of not-yet-taxed U.S. investment or interest income being routed to accounts at FFIs which are not FATCA compliant (this is a significant change from the proposed rule which would have begun FATCA withholding in 2014). For example, a member trying to send the untaxed proceeds of U.S. sourced investment or interest income to his or her account located at a not-FATCA-compliant FFI in a tax haven jurisdiction on January 1, 2017 or later would presumably be subject to withholding under this rule.

In addition, U.S. credit unions will likely need to perform a due diligence review of existing accounts – to determine if the credit union holds accounts for FFIs which are not FATCA compliant – by December 31, 2015, although few, if any, U.S. natural-person credit unions are likely to have such FFI accounts. Whether or not the credit union holds accounts of non-FATCA-compliant FFIs is unrelated to the due diligence and withholding requirements described above which take effect January 1, 2017 regarding transfers by members that are routed to accounts at non-FATCA-compliant FFIs.

- **Non-U.S. Credit Unions Which are Not Exempt Will Be Subject to FATCA Compliance and Reporting by March 2015 and Withholding in January 2017 or Later:** Non-U.S. credit unions which are subject to full FATCA compliance will be required to enter into agreements with the IRS to comply with FATCA as “Participating FFIs” (presumably during July-December 2013) and make regular reports to the agency beginning in March 2015, and will be required to file reports concerning the “U.S. accounts” (i.e. accounts held by U.S. taxpayers) it had open in 2013 and 2014 no later than March 31, 2015. Participating FFIs will be required to begin withholding 30% of “foreign passthru payments” in either: (i) January 2017 or (ii) 6 months after the IRS issues a final regulation defining “foreign passthru payment,” whichever comes later (to date, the IRS has not yet proposed a definition of “foreign passthru payment”).
- **Exemption for Pre-Existing Accounts at Participating FFIs:** “Pre-existing” accounts at Participating FFIs – i.e. those existing at the institution as of December 31, 2013 – will be exempt from FATCA if they are: (a) an account in the name of a natural person with a balance under US\$ 50,000 in value; or (b) an account in the name of a legal entity with a balance under US\$ 250,000. Pre-existing accounts with less than US\$ 1 million in assets (but more than US\$ 50,000 or US\$ 250,000 depending on the type of account) will only need to be reviewed for indicia of U.S. taxpayer status electronically; accounts over US\$ 1 million in value would need to be reviewed more thoroughly. Also, new accounts opened by a member who joined prior to December 31, 2013 can be treated as “pre-existing accounts,” as can accounts acquired in a merger, amalgamation, purchase and assumption transaction, or other business combination with another depository institution.
- **Other Exempt Accounts at Participating FFIs:** Accounts opened on January 1, 2014 or later which remain below US\$ 50,000 would also be FATCA exempt. Similarly, retirement accounts which have special status under local law would be exempted in most cases.



- **Key Compliance Dates:**

- Non-U.S. credit unions which are not “non-registering local banks” can begin registration with the IRS by July 15, 2013 and those registered by October 15, 2013 will be included on the IRS’s initial list of FATCA compliant FFIs that will be issued in early December 2013. Later registrations are likely permitted until at least January 1, 2014 – and probably later – although this point is not entirely clear and early registration appears to be encouraged. (“Non registering local banks” are not required to register with the IRS.)
- Participating FFIs must begin reporting to the IRS no later than March 31, 2015 regarding accounts held as of December 31, 2013 and in 2014.
- Participating FFIs and other withholding agents must document the FATCA status of non-exempt accounts they hold – including accounts held by FFIs, such as for correspondent banking purposes – by December 31, 2015 and presumably close accounts of FFIs which do not agree to comply with FATCA by that time.
- U.S. credit union FATCA due diligence and withholding begin January 1, 2017.
- Participating FFIs must begin withholding on “foreign passthru payments” on the later of: (a) January 1, 2017; or (b) 6 months after the IRS defines the term “foreign passthru payment” by rule.

### **1. Non-U.S. Credit Unions Subject to FATCA Intergovernmental Agreements Will Usually be Exempt from this IRS FATCA Regulation**

Credit unions in most jurisdictions which enter into FATCA IGAs with the U.S. Treasury will be exempt from this IRS FATCA regulation, depending on whether the applicable IGA is a “Model I” or “Model II” IGA, as detailed below.

The U.S. Treasury has released three styles of “model” FATCA IGA: (1) [Model IA](#) – which involves reciprocal account and tax information sharing by the U.S. and the other jurisdiction’s government; (2) [Model IB](#) – in which the jurisdiction’s government provides account information to the U.S. without reciprocity; and (3) [Model II](#) – where credit unions and banks would report directly to the IRS but the compliance rules and form of that reporting would be determined by the jurisdiction’s authorities to some degree.

Credit unions in “Model I” (i.e. Model IA or Model IB) jurisdictions – such as Great Britain, Ireland, and Mexico – will be completely exempt from this IRS FATCA rule and will instead follow locally developed FATCA rules such as those [proposed in the United Kingdom](#) by HM Revenue and Customs.

Credit unions in Model II jurisdictions – such as likely Japan and Switzerland and possibly other jurisdictions with privacy laws which make Model IA and Model IB infeasible – would be required to



follow the IRS FATCA regulation except to the extent that the applicable IGA supersedes the IRS regulation (no Model II agreements have to been finalized to date, so the practical implications of the Model II agreement on credit union FATCA compliance remain to be seen).

## **2. Non-U.S. Credit Union FATCA Partial Exemptions**

Non-U.S. credit unions in jurisdictions which have **not** entered into IGAs with the U.S. Treasury are likely to fall into one of two partial exemptions from FATCA. These are:

- a) **“Non-Registering Local Bank” Partial Exemption:** The final rule clarifies that credit unions and similar credit cooperatives can usually qualify as “non-registering local banks” if they: (1) only have offices in their home country; (2) have less than US\$ 175 million in total assets; and (3) meet a few other technical requirements such as not soliciting business from outside their home country. Non-registering local banks, such as many non-U.S. credit unions, will not be required to register with the IRS in order to comply with FATCA since the IRS is assuming that few small non-U.S. credit unions and similarly small FFIs are conduits used by U.S. taxpayers to avoid taxes.
  - **Key Change from Proposed Rule:** The IRS’s proposed FATCA regulation included a definition of “non-registering local bank” which referenced the definition of “bank” in Internal Revenue Code section 581; this proposed definition would not likely have applied to “credit unions” because “credit unions” are defined under section 501(c)(14)(A) of the Code, not under section 581. As requested by World Council, the final regulation deletes the reference to section 581 and expressly mentions credit unions and credit cooperatives in the definition of “non-registering local bank.”
- b) **“Deemed Compliant Local FFI” Partial Exemption:** A non-U.S. credit union with more than US\$ 175 million in assets will be exempt from most aspects of the IRS FATCA regulation as “Deemed Compliant Local FFIs” if it:
  - Only has offices in its home country;
  - 98% of the value of its accounts are held by residents and/or citizens of their home country (U.S. citizens’ accounts are also included within the 98% if the U.S. citizen is a local resident);
  - The credit union registers with the IRS using the FATCA Registration Portal, a secure internet-based registration system which should be on-line by July 2013, and receives as Global Intermediary Identification Number (GIIN) for FATCA compliance purposes (if the credit union registers before October 31, 2013 it will be on the IRS’s initial list of compliant institutions to be issued in December 2013; later registrations are allowed, however); and



- Meets a few other requirements, such performing some due diligence and establishing a few basic policies regarding U.S. accountholders. This will include certifying that the credit union does **not** have “practices or policies that discriminate against opening or maintaining accounts for U.S. individuals that are residents of the local FFI’s country,” and also **has** policies in place to not open new accounts for U.S. taxpayers who are not local residents (at least in the case of new accounts over US\$ 50,000 in value). (I.e. Local FFIs – somewhat confusingly – would not be allowed to discriminate against U.S. taxpayers who are residents of the Local FFI’s home country, but would also be required to discriminate against U.S. taxpayers who do not reside in and are not citizens of the Local FFI’s home country.)
  - **Key Changes from the Proposed Rule:** The IRS made several positive changes urged by World Council to the “Deemed Compliant Local FFI” definition which should make it easier for credit unions to meet this definition, including:
    - Removing a prohibition on FFIs having U.S. dollar denominated accounts listed on their websites (so long as this is not done in a way aimed at attracting U.S. taxpayers).
    - Removing a requirement that the Local FFI renew its IRS registration every three years; under the final rule, the Local FFI would never need to renew its IRS registration unless it has a “change in circumstances” which makes it no longer meet the definition of “Local FFI.”
    - Although the IRS did not adopt World Council suggestion to change the 98% minimum local resident account threshold to 95%, the IRS did make two changes to how the 98% local resident threshold is calculated which should make more credit unions eligible to be “Local FFIs:”
      - a. Determining the 98% of accounts held by local residents threshold by using the value of the institutions total accounts rather than the number of accounts (as had been proposed); and
      - b. Counting non-resident citizens of the credit union’s home jurisdiction as “local residents” for purposes of this test (e.g., if a Canadian citizen is a resident of a country other than Canada, he or she would still be considered a resident of Canada for purposes of the “Local FFI” definition at a Canadian credit union).



### **3. Non-U.S. Credit Unions which are Neither Exempt Nor in an IGA Jurisdiction**

Non-U.S. credit unions which are neither in an IGA jurisdiction, as discussed above under “1,” nor meet either of the partial FATCA exemptions, as discussed in “2,” will be subject to full compliance with this IRS FATCA regulation as “Participating FFIs.” Participating FFIs must enter into a FATCA compliance agreement with the IRS preferably by the end of 2013 but with reporting beginning by March 2015 (regarding years 2013 and 2014) and withholding beginning in January 2017 or later.

The details regarding Participating FFI FATCA compliance are too complex to be contained in this short summary and will be addressed comprehensively in World Council’s *FATCA Compliance Guide* when it is released this spring.

Participating FFIs will be expected to enter into FFI agreements with the IRS and receive a Global Intermediary Identification Number (GIIN) using the IRS’s online FATCA Registration Portal discussed above in section “2.” Participating FFIs which enter into agreements prior to October 15, 2013 will be included in the IRS’s initial list of compliant institutions (to be released in December 2013) and the rule implies that all institutions should be try to be registered before the end of 2014. In most cases, the Participating FFI will be required to report to the IRS information about the accounts it held on December 31, 2013 and during the year 2014 no later than March 31, 2015.

As part of the agreement with IRS, the Participating FFI will act as a “withholding agent” for IRS and begin withholding 30% of “foreign passthru payments” in either: (i) January 1, 2017 or (ii) 6 months after the IRS issues a final regulation defining “foreign passthru payment,” whichever comes later (“foreign passthru payment” will be defined in a future IRS rulemaking).

### **4. Accounts at Participating FFIs which are FATCA “Exempt”**

New and preexisting accounts with less than US\$ 50,000 in value are defined as an “exemption” from the definition of “U.S. account” (i.e. accounts held by U.S. taxpayers who are not local residents) and these accounts are therefore exempt from FATCA. There are also similar exemptions for retirement accounts which are legally recognized as retirement accounts under local law.

For accounts opened January 1, 2014 or later, the account is FATCA exempt until the member’s total funds held by the credit union exceeds US\$ 50,000 at the end of any calendar year (i.e. the credit union must aggregate the value of all of the member’s accounts if he or she has more than one account).

The rules are more lenient for “preexisting accounts,” i.e. those opened on or prior to December 31, 2013, which are further defined as “grandfathered obligations” under the rule.

Preexisting accounts can be FATCA exempt if for individuals (i.e. natural persons) if the member’s total funds held by the credit union is less than US\$ 50,000 in value on December 31, 2013 and the account’s total value remains less than US\$ 1 million at the end of any future calendar year.



Preexisting accounts in the name of a legal entity with a balance under US\$ 250,000 are also exempt unless the account exceeds US\$ 1million at the end of any future calendar year.

In addition, preexisting accounts with less than US\$ 1 million in assets (but more than US\$ 50,000 or US\$ 250,000, depending on the type of account) will only need to be reviewed for indicia of U.S. taxpayer status electronically, such as by reviewing the credit union's general computer account records. Pre-existing accounts over US\$ 1 million in value would need to be reviewed more thoroughly with a search of the credit union's paper (or scanned or microfiche, etc.) records related to the account.

New accounts opened by a member who joined the credit union prior to December 31, 2013 can be treated as "preexisting accounts." In addition, accounts the credit union acquired in a merger, amalgamation, purchase and assumption transaction, or other business combination with another depository institution can also be treated as "preexisting accounts."

Regarding retirement and pension accounts, the final rule eliminates the proposal's requirement that all contributions to the account be government, employer, or employee contributions in order for the account to be FATCA exempt. The final rule also liberalizes the limit on contributions to allow a FATCA exemption for retirement plans that either have an annual contribution limit of \$50,000 or less or a maximum lifetime contribution limit of \$1,000,000 or less, but adds the condition that relevant tax authorities must require information reporting with respect to the account in order for it to qualify for a FATCA exemption.

## **5. U.S. Credit Unions as "Withholding Agents"**

World Council will be working with the Credit Union National Association (CUNA) to develop compliance information for U.S. credit unions regarding this FATCA regulation. Some U.S. credit unions – i.e. those which send cross-border payments from the U.S. overseas – will be required to perform due diligence and 30% withholding on some types of payments being directed to FFIs which are not FATCA compliant beginning January 1, 2017 using Form 1042-S (this is a significant change from the proposed rule which would have begun FATCA withholding in 2014).

The IRS will likely issue additional guidance for U.S. withholding agents, including credit unions, prior to compliance with these FATCA provisions becoming mandatory. In addition, the final rule also establishes a safe harbor for U.S. institutions which rely on third party information about FFIs for FATCA compliance purposes.

These FATCA withholding requirements will only apply to a narrow set of international payments which should help limit FATCA due diligence and compliance burdens on U.S. credit unions. FATCA withholding will only apply to transfers of not-yet-taxed proceeds of investment or interest income earned from a U.S. source, such as dividends paid on a U.S. credit union account or proceeds from the sale of a U.S. based investment, which is being routed to an account at an FFI which is not FATCA compliant.



These accounts at non-FATCA-compliant FFIs are confusingly called “U.S. accounts” in the regulation because they are accounts in the name of a U.S. taxpayer (notwithstanding that the account is neither located in the U.S. nor held by a U.S.-chartered financial institution). In general, a “U.S. account” is “any financial account maintained by an FFI that is held by one or more specified U.S. persons or U.S. owned foreign entities.”

FATCA withholding will **not** apply to payments involving U.S. source: wages or other payments for services, payments for goods, lease or rental payments, gambling winnings, payments in connection with transportation or freight, awards, prizes, scholarships, and interest on outstanding accounts payable for goods or services rendered.

In addition, U.S. credit unions – if any – that have accounts at their institutions in the names of FFIs which are not FATCA compliant would also be expected to identify these accounts by December 31, 2015, and close such accounts if the FFI refuses to comply with FATCA. This requirement is separate from the withholding required on payments being routed to non-compliant FFIs’ confusingly named “U.S. accounts” which begins in January 2017.

An important addition to the FATCA final rule is a safe harbor for U.S. credit unions which rely on “third-party data providers” that maintain lists of FFIs which are or are not FATCA compliant. Several major vendors, such as Thomson Reuters, have recently announced that they will release FATCA compliance tools which appear likely to meet the criteria for this safe harbor (which was not included in the proposed version of the rule).

The final rule also allows U.S. credit unions to rely reasonably on other sources of information not included in the proposed rule, such as the representations of correspondent institutions and agents, electronic documents which have not been notarized, payee information which does not have a complete address, pre-FATCA W-8 forms, non-IRS forms which contain similar information to Form W-8 or Form 1042-S (including if those forms are not in English), and so forth.

More details on the FATCA final rule’s impact on U.S. credit unions will be addressed in World Council’s *FATCA Compliance Guide* and/or in CUNA compliance materials.

## **Conclusion**

The IRS’s final FATCA regulation makes many changes from the agency’s proposed regulation which will help limit FATCA’s regulatory burdens on both non-U.S. credit unions and U.S. credit unions. World Council urged many of these changes and the IRS made other helpful changes even when the agency took a different approach from what we recommended. Nevertheless, this FATCA regulation will impose many new regulatory burdens on credit unions around the world and World Council remains committed to helping credit union systems minimize FATCA’s burdens on credit unions’ ability to provide low-cost financial services to their members.

This short summary addresses the most important provisions of the IRS’s 544 page final regulation and the final rule’s key changes compared to the original proposal. All materials details from the final regulation, including practical compliance information, will be addresses in the World Council’s





forthcoming *FATCA Compliance Guide*. If you have any questions about this summary or regarding aspects of the IRS's FATCA final rule not addressed in this summary, please contact Chief Counsel and VP for Advocacy & Government Affairs Michael Edwards at [medwards@woccu.org](mailto:medwards@woccu.org).