

FATCA Implications for Financial Institutions and US Persons in Switzerland



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While the FATCA IGA Model 2 agreement signed on February 13th between Switzerland and the United States is a very positive step forward for both countries in the fight against tax evasion, the 544 pages of complexity released by the US Treasury and the IRS on January 17th [Following the 388 pages released February 8, 2012] has some very clear winners and losers and will certainly be the cause of tremendous costs, and perhaps to small independent asset managers in Switzerland. **[Annex II, Section II, A, 2 on Page 31 of the Swiss-US Agreement references Swiss Investment Advisors: The language is not clearly written though it seems to suggest that Swiss Investment Advisors are exempt if they manage accounts without custody at FFIs or deemed compliant FFIs (or they don't manage investments at non participating financial institution), but the language needs clarification.]**

Before discussing the implications, it will be useful to understand the new language of FATCA. For those readers not familiar with FATCA, this comes out of US legislation whose primary purposes is to help the US government find US taxpayers who are avoiding US taxes on their worldwide income. This effort however places substantial burdens on financial institutions all over the world; also because the USA is the only country in the OECD who imposes worldwide citizenship based taxation on both their residents and citizens regardless of where they live.

Reading the over 900 pages of official FATCA texts has been terribly challenging for the author, a native English speaker with years of experience in complying with financial regulations in both the

United States and Switzerland. Even as a specialist in US cross border tax and financial issues, an occasional lecturer at IMD and with a Master's Degree in Business from New York University, understanding how to fully comply with the rules for the author's own businesses remains a formidable challenge. The following article aims to provide some insight and preliminary guidance to the small business community in Switzerland and Americans living in Switzerland in order that we all may survive this legal tsunami. So, first a summary of some of the more common terms in the FATCA regulations may be useful in understanding this and other articles:

Foreign Financial Institution (FFI): Any financial institution that is a foreign entity. The list included, but is not limited to banks, insurance companies, many but not all trusts, investment advisors (even if they don't hold custody of client assets), holding company, treasury center, collective investment vehicle, entities that make commercial loans, an entity that buys or sells accounts receivables, provides trust or fiduciary services, finances foreign exchange, etc. (The actual definition is many pages long and has some exceptions.) it is a project for most entities just to determine if they are an FFI.

There are many categories of FFIs including: Deemed Compliant FFIs, Certified Deemed Compliant FFIs, Registered Deemed Compliant FFIs and Owner Documented FFIs each with its own particular definition and requirements.

Registered Deemed Compliant Procedural Requirements: The final regulations provide a registered deemed-compliant FFI with six months from the time it becomes ineligible for the registered deemed compliant status to cure the default or notify the IRS of its change in status.

Non Participating FFI: The term non participating FFI means an FFI other than a participating FFI, a deemed-compliant FFI, or an exempt beneficial owner.

Non Reporting IGA FFI: The term non reporting IGA FFI means an FFI that is identified as a non-reporting financial institution pursuant to a Model 1 IGA or Model 2 IGA that is not a registered deemed-compliant FFI.

Non Financial Foreign Entity (NFFE) means a foreign entity that is not a financial institution.

Sponsoring entity: The term sponsoring entity means an entity that registers with the IRS and agrees to perform the due diligence, withholding, and reporting obligations of one or more FFIs.

Sponsored FFIs: The term sponsored FFI group means a group of sponsored Foreign Financial Institution whose shared sponsoring entity is responsible for the FATCA reporting and the compliance of all of underlying FFIs. [e.g. if a Trust company is the sponsor of all of the trust where it acts as a Trustee.]

Non-Participating FFI: This essentially means all non US financial institutions other than FFIs or deemed compliant FFIs.

FFI Agreement: An agreement between a Foreign Financial Institution and the IRS that will require the FFI to collect certain information on their clients and in many cases to report annual information to the IRS as well as withhold US taxes on certain US income and other payments. [It has been noted that the IRS will not be able to perform on sight compliance audits of Swiss FFIs though it appears that they may request this type of assistance from the Swiss government.]

Model I & II Governmental Agreements (IGAs): The US Treasury department has collaborated with other governments to develop two alternative model intergovernmental agreements to facilitate the implementation of FATCA; primarily by removing legal impediments to data reporting cross borders.

Countries that sign and use the Model 1 agreement [First published on July 26, 2012] will have their FFIs report information directly to their home government about US accounts and account holders, and that government will report the information to the IRS on an automatic basis.

Countries that sign and use the Model 2 agreement [first published on November 14, 2012] will direct and enable their FFIs to report information directly to the IRS. In this agreement, their still will be room for government to government exchanges.

The IRS is hoping to conclude over 50 signed agreements in the near future, though to date less than ten have been signed with the Swiss agreement being one of the first.

IRS Reviews: The IRS may make general inquiries to FFIs requesting additional information regarding information reported (on forms 1042, 1042-S, 8966 or additional annual reporting that may be required in the future) on a regular basis to the IRS. The IRS may also make inquiries to FFIs if they suspect “substantial non-compliance” with an FFI agreement. These inquiries are not expected to be made on a regular basis. If an FFI has been found to be non-compliant with the FFI agreement, the IRS will allow an FFI to develop a plan to come into compliance rather than immediately suspending the FFI.

Specified United States Person: A specified US person is generally a US citizen, US resident or for other reasons a person (or entity) that is liable for US taxes; though there are many exceptions for entities. Companies that are regularly traded in the public markets, organizations exempt from US taxes, entities of the US Federal or State governments or any sub division. See page 499 for more details.

Recalcitrant Account Holders: The account holder fails to comply with requests by the FFI for the documentation or information that is required under for determining the status of such account as a U.S. account or other than a U.S. account. [The definition goes on for many pages, this is a brief summary.]

Withholdable Payment: Any payment of US source FDAP (Fixed or determinable annual or periodic) income. Also includes and is not limited to: Investment advisory fees, custodial fees, bank and brokerage fees, payments in connection with lending transactions, amounts paid under cash value insurance or annuity contracts, dividends, interest, interest on outstanding accounts payable etc.

Withholding Taxes: FATCA imposes a 30 percent withholding tax on certain U.S.-source payments (and payments of gross proceeds from the disposition of property that can produce such payments) made to an FFI unless the FFI enters into an agreement with the IRS to report the identities and other information about its US account holders. FATCA also requires FFIs that enter into such agreements (participating FFIs) to withhold 30 percent of “pass thru payments” made to other FFIs that do not comply with the FATCA rules. FATCA requires NFFEs to report information about their substantial US holders to paying agents in order to avoid a 30 percent withholding tax.¹

FATCA Registration Portal: FFIs registering with the IRS will be able to do so through an online portal designed to accommodate a paperless registration process. It is expected that the Portal will be available no later than July 15, 2013. [Though it appears that annual reporting will be done on “magnetic media” and possibly through electronic files; which seems quite a burden for those entities that may have only a few US account holders and no withholding to report and submit.]

Global Intermediary Identification Number (GIIN): This is a number that will be assigned to an FFI to establish its status for withholding purposes and to identify the institution to the IRS for reporting purposes.

IRS FFI List: The IRS is expected to publish the first list of participating FFIs and registered deemed compliant FFIs on December 2, 2013 and the IRS intends to update the list monthly. FFIs have to register by October 25, 2013 to ensure inclusion on the first list.

Relationship Manager: Is an officer or other employee of an FFI who is assigned responsibility for specific account holders on an on-going basis (including as an officer or employee that is a member of an FFI’s private banking department), advises account holders regarding their banking, investments, trust, fiduciary, estate planning, or philanthropic needs, and recommends, makes referrals to, or arranges for the provision of financial products, services, or other assistance by internal or external providers to meet those needs. Notwithstanding the previous sentence, a person is only a relationship manager with respect to an account that has a balance or value of more than \$1,000,000, taking into account the aggregation rules.

The above definitions are by no means complete and may contain inaccuracies and other exclusions. The definitions as written by the IRS are in many cases unclear, not obvious and evolving and it is hoped that some plain English guidance may be published in the future, though this seems unlikely. The IRS has not published the number of staff who will be working in this area,

but if the ratio is similar to what they have for US taxpayers, especially those living overseas, long waiting times and inconsistent responses should be anticipated.

For those unaccustomed to working with the IRS, you should become familiar with the division of the IRS called the Taxpayer Advocate. Nina Olson, the current head of the Taxpayer Advocate and her staff have done an excellent job of highlighting to the US Congress what does not work well at the IRS and being a voice for change and moderation. The Taxpayer Advocate's annual report carries significant weight though the IRS's implementation of improvements is often slow. Now that many FFIs are becoming in fact "agents" of the US, it may be presumed that any deficiencies in the IRS handling of FATCA can be reported to her office.

<http://www.irs.gov/uac/Taxpayer-Advocate-Service-6>

Now let's look at some of the Winners and Losers out of FATCA and here you may be able to find how you or your organization may be affected.

The Winners

- The **US government**, starting in 2014, should start to receive tremendous amounts of data about US citizens who have financial accounts in Switzerland as well as Swiss citizens who have accounts in Switzerland but live in the United States. Of almost 40,000 US citizens who are estimated to live in Switzerland, [Minus the over 900 of whom have renounced their US citizenship in 2012 along according to Ambassador Beyer] and the estimated >70,000 Swiss citizens who live in the United States, they will continue to be lumped together with the real US target, US citizen tax evaders who are largely thought to live in the US. My best guess is that the true US tax evaders have long since moved their accounts out of Switzerland and the IRS will end up targeting the relatively innocent, if un-informed US and Swiss middle class employees and retirees who live in Switzerland and who have been confused by the terribly complex US tax system.

The February 16, 2013 special report in *The Economist* on Offshore Finance estimates, on page 4, that the total North American assets in Swiss Banks to be a small fraction (estimated at less than 2%) of the total wealth managed in the country. It will be interesting to see how much extra tax the US treasury takes in from FATCA implementation in Switzerland, presumably it will be a lot less than the cost of Swiss institutions to implement FATCA, though this may be a reasonable price to pay to normalize the future of Private Banking in Switzerland?

- **US Citizens living in Switzerland will no longer be discriminated against by Swiss Financial Institutions.** Swiss bank management, take notice: Pages 76 and 432 clearly state that if you have practices and policies that discriminate against opening or maintaining accounts of US citizens who live in Switzerland, your status as a compliant FFI (Foreign Financial Institution) will be in jeopardy. Imposing high minimum account balances for US citizens or excessive fees may also be considered discriminatory practices, so all banks and

other financial entities should seek legal counsel on this matter if they intend to be registered as compliant FFIs. Organizations such as ACA (American Citizens Abroad who advocate for the rights of American Citizens overseas) have been fielding complaints for years about this discrimination and have already been in discussion with the US Treasury Department and Congressional staff in the US the week of February 11th to safeguard these provisions. US Citizens living in Switzerland who are refused access to financial institutions or who believe they have been discriminated against should contact the IRS, their representatives in Congress and the US Embassy in Bern, though no formal complaint channel yet exists.

- **US Citizens who have considered renunciation of their citizenship:** Many US citizens in Switzerland have considered and acted upon the renunciation of their US citizenship. With the current change of events due to FATCA, this should improve access to financial services overseas, which was often cited as a reason for renunciation. The question to renounce citizenship may become more of a financial issue than anything else [as it has been in the last few years] if the US citizen finds that complying with tax laws in the US to be too complex or too expensive or both. ACA has recently proposed changes to tax laws in their very comprehensive and well received Residency Based Tax (RBT) proposal written by Jackie Bugnion. ACA are actively seeking support in the US Congress for this proposal. If RBT is enacted, a big IF, even in part, it could remove many of the financial reasons for considering expatriation for overseas Americans.
- **The Swiss Government** should be applauded for being one of the first countries in the world to sign an IGA (inter-Governmental Agreement) with the United States which shows that Switzerland is truly committed to shedding its former image as a jurisdiction where tax evaders could hide their income and assets with impunity. February 2013, will likely be seen as a positive turning point in Swiss-US financial relations.
- **Consulting firms who have built up expertise on FATCA** compliance will certainly be in high demand and will be able to command high fees to help Swiss and other non US based Financial Institutions to comply with the FATCA rules, which are still being written. Time seems short for compliance and so consulting fees will certainly be outrageously high for the remainder of 2013 and 2014.
- **US Tax accountants and lawyers who are skilled in the US OVDI** program will also get even busier as the final holdouts of US citizens overseas, who have been afraid to come into the US system, will have no choices left but to become current on their US tax and FBAR filing requirements.
- **Swiss Financial Institutions** who have invested in knowing their clients, understanding their KYC data and embracing working with US Citizens by training their staff on US matters will find that they can comply with the IRS requirements and perhaps even delight their US

citizen clients. Congratulations to UBS, where this process started over 5 years ago, to new and relatively simple paperwork for working with US citizens in Switzerland. As long as the US person is willing to sign a W9 form and an authorization to allow information to be reported to the IRS along with some other minor information, UBS now appears open for business again for US citizens resident in Switzerland. Thank you UBS!

- **Foreign Trusts with individual (not professional) trustees** will be treated as NFEs so will not have as burdensome requirements as registered FFIs, NFEs will still need to declare to FFIs (presuming that's where assets are held in custody) if they have any substantial US persons (e.g. as beneficiaries) otherwise they will risk having withholding taxes applied to certain income and payments.
- **Large Financial Institutions with many account holders:** The final FATCA regulations simplify the due diligence requirements based on the aggregate account values and risk profile of the accounts and allow FFIs to rely on information they have already collected in many cases, which generally already falls under the various Know Your Client regulations. FFIs will also have more time, as was expected, to implement FATCA requirements. All accounts created before January 1, 2014 will be considered pre-existing accounts. Reporting by FFIs for 2013 and 2014 will not be due until March 31, 2015. Finally, FFIs will have until December 2015 to document account holders and payees who do not appear to be themselves other FFIs.
- **Holders of Swiss Retirement Accounts:** Retirement accounts such as 2nd and 3rd pillars and vested benefits insurances are exempt from FATCA reporting; so if you are an American retired in Switzerland and have been worried that your retirement accounts would get caught up in the FATCA mess, it appears that they will be exempted. [See more details in the US Swiss IGA.]

The Losers

- **Swiss Financial Institutions and employees** who think that banking secrecy in Switzerland will survive unscathed and that they can just ignore the FATCA regulations by not working with US clients or getting rid of their US clients will find that doing business with compliant FFIs will be costly if not impossible. Just because they don't work with any US clients will not absolve most financial institutions from complying with FATCA regulations. Institutions and individuals who have been helping US citizens evade taxes will continue to be prosecuted by the US government. Most if not all Swiss Banks will become compliant FFIs. Not being on the IRS FFI list will be a big business impediment for all financial entities outside the US.
- **Relationship Managers:** If you are an employee of an FFI and are assigned responsibility to work with clients who have assets of over \$1 million [especially US persons], you will potentially be having your name exposed to the IRS [the instructions here are in my reading 7

not too clear yet] as associated with high value accounts. Considering that many Swiss bank employees had their names already exposed to the IRS [without their permission] and have had considerable disruption to their personal lives, employees will want to be cautious. Swiss employees should strongly consider how their employer will manage conflicts of interest and potential legal protection situations as well as review their current employment contracts, perhaps by outside counsel.

- **Non participating FFIs:** Financial Institutions, even if they do not work with any American clients, if they choose not to participate in the FATCA program will find themselves on the outside of the world's main financial industry and this will be costly. Certain payments that are made to non participating FFIs from FFIs will have taxes withheld (e.g. on US source income or any other withholdable payment). Increasingly non participating FFIs are likely to be blacklisted and undesirable from the standpoint of doing any sort of business with FFIs. A non participating FFI will likely find it hard to even open or retain a bank account at an FFI as well.
- **US Citizens who have been truly evading taxes** and have their information reported to the IRS through FATCA will be dealt with harshly; the penalties will be high and potential prison time is real.
- **US Citizens who have not intentionally been evading US taxes** but who nonetheless have been ignorant of US tax laws or who have been lackadaisical or very late in filing their US tax returns and Foreign Bank Account forms may find themselves in costly battles with the IRS and the US Treasury Department to prove their intentions. My advice to get help now [please don't call the author, though, as he is not a tax or legal advisor.]
- **Swiss Financial Institutions who want to comply with FATCA** will have to spend a tremendous amount of resources, on updating their IT systems, business processes and compliance procedures to act as agents of the US Internal Revenue Service. Never in the history of cross border laws has any legislation forced so many institutions in a foreign country to act as tax collectors for one government. FATCA will go down in history as a turning point in cross border jurisprudence. The costs of complying with FATCA will be a rather large initial and on-going tax on most financial institutions with very few companies finding this as a profit center.
- **Small & Medium Sized Independent Investment Advisors**, who don't have custody of client assets have, [this was an addition in January 2013] under the final regulations being defined as financial institutions and could be burdened with excessive costs, which will largely duplicate the efforts of banks who hold the custody of client assets. After investing tremendous time, effort and cost just to try to understand the rules and comply with them, these Independent Advisors will find that they might have to comply with FATCA or risk being shut out of business by large companies. Firms with say 100 or less clients who have

more than 2 clients outside of Switzerland or the EU will have to either drop some of their distant foreign clients (e.g. in Asia, Africa, Eastern Europe, the Middle East, etc) or comply in a similar fashion as large financial institutions. One positive note is that the advisors who don't have custody of client assets have an exception to the requirement to withhold taxes like the larger institutions. See pages 23, 96, 176, 178, 481 for more information of the January 17, 2013 announcement on the "final rules".

- **Swiss and other non US Trust Companies:** Trust companies outside of the US will be classified as FFIs and so too will many of the underlying trusts that they are responsible for. "Globally trust companies are scrambling to understand how they should best structure their operations and trying to figure out if the underlying client's trusts are indeed FFIs," says Yves Bonnard, a well-respected international Estate Planning attorney at the law firm Bonnard & Lawson in the Suisse Romande. Mr. Bonnard is concerned at the tremendous cost to trust clients and the entities they work with, especially those who have no connections to the United States, of just trying to understand the legislation and how to stay compliant with FATCA.

Even though there have been delays in implementation, those institutions and individuals who have hoped that FATCA would be repealed or significantly scaled back must realize that FATCA is upon us and will become part of the fabric of the global financial markets. The final history has not been written and there will be significant unintended consequences as a result of this monstrous legislation.

The Swiss Federal government has opened a very short 4-week window, starting on February 13th, for interested parties to submit their views. I strongly suggest the following for independent investment advisors in Switzerland (and globally):

Swiss Investment Advisors

Annex II, Section II, A, 2 on page 31 of the Swiss-US Agreement references Swiss Investment Advisors and needs to be written in comprehensible English.

A Swiss Independent Asset Manager should be considered a deemed compliant FFI if all of the assets they manage (and/or clients they work with) are held in safe custody by either a US Financial Institution or a Swiss or European registered FFI or deemed compliant FFI, and the Swiss Independent Asset Manager does not exercise custody or full power of attorney over these accounts. If this is what the above section is intended to accomplish, it needs to be clarified.

This would surely eliminate substantial duplicate reporting of accounts to the IRS and would allow Swiss investment advisors relief in the regulatory maze of FATCA. US Account holders would still be reported to the IRS by the US Institutions (through the current 1099 reporting) or by Swiss and European FFIs through the Model 1 and Model 2 agreements that are likely to be signed.

Swiss Investment Advisors still need a way to show to FFIs and potentially others that they meet the requirements of Annex II, Section II, A, 2 on page 31 of the Swiss-US Agreement. This is necessary so that investment advisory fees and other transfers are not subject to withholding taxes and that FFIs do not mistakenly think of Swiss Investment Advisors as non participating FFIs. Perhaps the Swiss Investment Advisors will be required to register as an FFI through the IRS portal and would have to certify that they meet the requirements of this exception but this too remains unclear.

If you are an independent asset manager in Switzerland, work for an SRO or otherwise support independent asset managers, I strongly encourage you to make your voice heard in Bern and ask for a clarification to ensure that Swiss Investment Advisors will not be subject to most of the cumbersome FATCA reporting and duplicate the efforts of the banks which look like they will have to mostly comply as FFIs.

Conclusion

More details from the Swiss Federal Government can be found here: <http://www.admin.ch/aktuell/00089/index.html?lang=en&msg-id=47779>

The following link to the IRS site has several further links to the full FATCA text.

<http://www.irs.gov/Businesses/Corporations/InformationforForeignFinancialInstitutions>

The estimates of the cost of complying with FATCA range well into the Billions of dollars yet the US Treasury only expects to earn a relatively small \$800 million dollars [globally] per year in additional revenue. Let us all hope that the signing of the agreement between the United States and Switzerland marks the end of the financial battles between the two governments and that both countries and their citizens will be better able to conduct their lives free from the worry of unnecessary repression and move towards a brighter future of cooperation.

¹ Text on **Withholding Taxes** was copied from the excellent summary from the following article: http://www.martindale.com/taxation-law/article_Skadden-Arps-Slate-Meagher-Flom-LLP_1668400.htm and is not the author's original work.

Authors note: The author asks the readers for forgiveness in any factual or grammatical errors. The author is neither an attorney nor a CPA and none of the information here should be considered as legal or professional advice. The subject is complex and the amount of information is daunting; this article is a preliminary attempt to try and make sense of the current environment. With the exception of footnote 1, the primary source of information for this article is the original texts published by the IRS or quotations as otherwise noted. The original article was first written in English. Any opinions expressed are solely of the author and not any organizations he works with or for.



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