

Implications of FATCA for Cayman Islands entities

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What is FATCA?

FATCA or the Foreign Account Tax Compliance Act, is actually a section of the Hiring Incentives to Restore Employment (HIRE) Act passed into United States ('US') law in March 2010, that comes into force on 1 July 2014. It is unique in its extra-territorial reach, being an attempt to force financial institutions ("FIs") worldwide to report on their US tax resident accountholders and imposing sanctions for non-compliance. The starting point is that all non-US FIs should be forced to register with and identify their US tax resident accountholders to the IRS or face a 30% withholding tax on gross payments from US payors.

What is the Cayman IGA?

The Cayman IGA or Inter-Governmental Agreement between the Cayman Islands and the US, is an agreement to introduce domestic legislation in the Cayman Islands requiring certain FIs to report US tax resident accountholders to the Cayman Islands Tax Information Authority (the "TIA"), which will then pass that information to the IRS. By virtue of this IGA, FIs in the Cayman Islands are not required to enter into separate agreements with the IRS and will report to the TIA instead of the IRS.

Which Cayman Islands Entities are affected?

Only certain categories of Cayman Islands FIs are directly affected by the reporting requirements. Other entities will only be affected indirectly, for example, by the need to provide additional information when opening accounts with FIs.

Four categories of Cayman Islands FIs ("**Reporting FIs**") will be required to report their US tax resident accountholders to the TIA:

- **Custodial Institutions** – any FI holding financial assets for the account of others.
- **Depository Institutions** – any FI accepting deposits in the ordinary course of banking or similar business.
- **Investment Entities** – most investment funds (other than certain regulated funds with restricted categories of investor and most pension funds), administrators and some advisors/managers.
- **Specified Insurance Companies** – insurers liable under certain cash value insurance and annuity contracts.

Some FIs that would otherwise be Reporting FIs are exempted, including, for example, certain small and/or local FIs and FIs with a sponsor that has registered with the IRS and is reporting on their behalf.

What is a Reporting FI required to do and by when?

[Register for a GIIN by 1 January 2015](#)

Register as a Registered Deemed-Compliant FFI on the IRS FATCA Registration Portal to obtain a global intermediary identification number ("**GIIN**"). By virtue of the Cayman IGA, all Cayman Islands Financial Institutions are exempt from FATCA

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withholding tax from 1 July 2014 (when it commences) until 1 January 2015. From that date, they will not suffer withholding by US payors if they can provide payors with a GIIN.

Perform due diligence on pre-existing accounts (i.e. accounts existing at 30 June 2014)

Due diligence can be performed by the Reporting FI or delegated to a third party. Small accounts (up to \$50,000 for individuals and up to \$250,000 for entities) are exempted from the due diligence requirements, unless they later become higher value accounts.

Individual accountholders: generally, so long as the Reporting FI's electronic databases would reveal the following information, it will only be necessary to review electronically searchable data for indications that an accountholder is a US tax resident ("US Indicia"):

- Nationality or residence status
- Current residence and mailing addresses on file
- Current telephone number on file
- Any standing instruction to transfer funds
- Whether there is an "in-care-of" or "hold mail" address
- Whether there is any power of attorney or signatory authority.

If the electronic databases would not reveal all this information it will be necessary to review the paper files for accounts over \$1 million.

US Indicia can generally be overridden by contrary self-certifications or other evidence.

The review should be conducted by 30 June 2015 (or by 30 June 2016 for accounts up to \$1 million).

Entity accountholders: the first step is to review the AML/KYC files (and for FIs, the GIINs on the published IRS list of foreign FIs) to determine if the accountholder is one of the following:

- US tax resident
- Non-US entity controlled by US tax residents (if the account is over \$1m, also obtain self-certification as to identity of controllers)
- Nonparticipating FI (i.e. an FI that hasn't entered into an agreement with the IRS when it should have or is in breach of its reporting obligations)

The review should be conducted by 30 June 2016.

Obtain due diligence on new accounts (i.e. accounts opened after 30 June 2014)

For new accounts a Reporting FI will be required to undertake certain procedures when the account is opened (or within 90 days of it ceasing to be exempted) to identify reportable accounts (except for accounts with balances that do not or cannot (in the case of entities) exceed \$50,000).

Individual accountholders: the Reporting FI must obtain a self-certification from the accountholder as to whether or not it is a US tax resident and cross-check the answer against any other account opening documentation (including AML/KYC documents) to determine if it is reasonable.

Entity accountholders: except where the accountholder's status can be determined from a GIIN, the Reporting FI must obtain a self-certification to determine if the accountholder is one of the following:

- US tax resident
- Non-US entity controlled by US tax residents
- Nonparticipating FI (i.e. an FI that hasn't entered into an agreement with the IRS when it should have or is in breach of its reporting obligations)

A self-certification or other evidence cannot be relied on if the Reporting FI knows or has reason to know that it is incorrect or unreliable. If the accountholder fails to provide a correct self-certification, the account must be treated as a reportable account.

Report to the TIA

Reporting FIs will be required to report the identity and account balance or value at year end of accountholders identified by the due diligence process as being (i) US tax residents or (ii) non-US entities controlled by US tax residents. Accounts of Nonparticipating FIs are not themselves reportable, but any payments to Nonparticipating FIs are reportable.

With respect to reportable accounts identified in 2014 only basic information about the accountholder and account balance or value is reportable. For 2015, additional information on gross income paid or credited to custodial and depository accounts is required, and for 2016, information on proceeds of property sales or redemptions paid or credited to custodial accounts is also required.

For 2015 and 2016 Reporting, FIs must also report the name of any Nonparticipating FI to which it has made payments and the amount of such payments.

The required timing of these reports will be set out in the Cayman Islands legislation implementing the Cayman IGA, but since the Cayman IGA requires the TIA to provide the information to the IRS within nine months of the relevant year, Reporting FIs will presumably have a shorter period to file reports with the TIA.

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Will a Reporting FI be required to withhold tax from or close the accounts of accountholders who do not provide required information?

The Cayman IGA specifically exempts Reporting FIs in the Cayman Islands from any requirement to withhold tax from or to close the accounts of recalcitrant accountholders.

Is the US the only jurisdiction taking this approach?

The Cayman Islands has also entered into a similar IGA with the United Kingdom ('UK'). The UK IGA contains broadly similar due diligence and reporting obligations with respect to UK tax residents, although the criteria for identifying UK tax residents are narrower (since the UK does not tax its non-resident citizens) and there is no threat of withholding tax for non-compliance.

What steps should be taken now?

Clients with Cayman Islands entities are advised to take the following steps during the course of this year:

- Identify whether the entity will qualify as a Reporting FI
- Identify whether the entity could potentially suffer FATCA withholding tax – i.e. will it have any income paid directly or indirectly from a US payor.
- If the entity is a Reporting FI:
 - Register it on the IRS FATCA Portal to obtain a GIIN
 - Assess whether the entity's electronic records would include all US Indicia obtained from accountholders (and if so, whether similar indicia for UK tax residents would also be included)
 - Determine methodology for due diligence (e.g. conduct in-house or outsource).
 - Prepare to commence due diligence process after 30 June 2014
 - Review account opening procedures and update to require additional AML/ KYC and self-certifications as necessary from 1 July 2014.



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