

How FATCA Will Affect Brokers Dealing with Foreign Insurers and Agents

Congress passed the Foreign Account Tax Compliance Act (FATCA) in 2010 following the revelation that one of the world's largest and most well-respected financial institutions, the United Bank of Switzerland (UBS), aided and abetted U.S. taxpayers in evading income taxes through unreported foreign financial accounts.

FATCA was the product of the revelation to U.S. law enforcement and Congress that the scope and prevalence of overseas tax evasion was far more serious than previously thought. Given the broad reach of FACTA, some would argue that Congress overreacted. However, the UBS case and others revealed that overseas tax evasion was not limited to small, outlaw banks operating in the shadows, but was part of regular business operations of some of the largest and most reputable financial institutions in the world. FATCA, therefore, has an exceedingly broad reach, extending into areas not traditionally thought to pose a risk of overseas tax evasion. Unfortunately for insurance professionals, one such area is the purchase and sale of insurance products.

In attempting to comply with FATCA's requirements, it is helpful to understand what FATCA was meant to combat: U.S. taxpayers holding assets overseas in order to evade paying their U.S. taxes. Pure insurance protection products present little or no risk of being used for tax evasion, whereas products with an investment

component, such as a cash-value insurance or annuity contracts, present greater risks. Dealing with reputable and well-known non-U.S. brokers or insurers is far less risky than dealing with smaller or new ones. Until the IRS provides guidance or instructions on the obligations of withholding agents, brokers simply need to be aware of the risks that their clients, insurers and products could present.

FATCA imposes obligations on non-U.S. financial institutions to identify foreign financial accounts as assets that U.S. taxpayers own or control. The extremely broad definition of a foreign-financial institution can include non-U.S. insurance companies. The complication for insurance brokers is that FATCA imposes a corresponding obligation on payers to foreign-financial institutions to ensure that the foreign-financial institution is complying with FATCA or is exempt from FATCA regulation. FACTA imposes a 30% withholding penalty if the foreign-financial institution is not in compliance, which the payer is obligated to withhold for the IRS. For insurance

brokers, the 30% penalty could represent 30% of an insurance premium payment to a foreign insurer. There may be draconian penalties for withholding agents who fail to withhold, such as the amount of tax not withheld.

FATCA reporting for withholding agents imposes two basic requirements on insurance brokers. First, insurance brokers must verify the foreign insurer recipient's FATCA status. Second, insurance brokers must report payments, such as premiums paid to the foreign insurer.

The IRS has provided forms to meet both requirements. The broker uses IRS form W-8BEN-E for the first requirement — identifying the foreign insurer's FATCA status. The broker must collect the Form W-8BEN-E from the foreign carrier verifying that the foreign recipient of the premium payment is FATCA compliant or is exempt from FATCA's requirements.

The most common way a foreign carrier will be FACTA compliant is by agreeing with the IRS to comply with its obligations under FATCA, a so-called "participating foreign-financial

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institution." The IRS maintains a list of participating foreign-financial institutions accessible through its website.

The insurance broker must conduct some due diligence to ensure that the Form W-8BEN-E has been completed accurately. The IRS recently published regulations providing general guidance for withhold-

ing agents, such as brokers, and for foreign recipients to complete the Form W-8BEN-E, but how these due diligence regulations will be applied will develop over time.

Suppose that a foreign insurance carrier didn't provide the Form W-8BEN-E, claimed to be a participating foreign-financial institution, but didn't appear on the IRS database or was otherwise not exempt. The broker would have to withhold 30% of the premium, in which case there will be no coverage for the insured, or simply not do business with the foreign insurer. The broker has a continuing obligation to collect and retain Form W-8BEN-ES; the forms are only valid for three years.

A U.S. broker, such as a foreign insurance broker, must verify the FATCA status of each foreign intermediary that is used as well as the ultimate foreign insurer recipient. The foreign broker attests to its FATCA status on an IRS Form W-8IMY. The Form W-8IMY is transaction specific. The obligation can be bothersome for a chain of foreign intermediaries; the broker would have to collect Form W-8IMYs from each foreign intermediary and Form W-8BEN-E from the ultimate insurer recipient.

The broker would use IRS Form 1042-S to meet the second requirement — reporting amounts paid to foreign insurers. Brokers only have to report to the IRS the previous year's premium payments for U.S. risks made to non-U.S. insurer carriers. While the IRS has published instructions for the form, specific issues for insurance brokers await further clarification, such as whether to report premium payments if the broker doesn't have complete information on whether the risk insured is a U.S. risk.

While it all seems quite burdensome, FATCA was designed to be overly broad because Congress and the American public learned from the UBS case that overseas tax evasion by American taxpayers was far more pervasive and involved far more active participation by the world's largest financial institutions than previously thought. Unfortunately for insurance brokers, it means that FATCA imposes reporting burdens on industries that have not been traditionally associated with tax evasion, such as insurance. FATCA shifts the burdens to foreign financial institutions and those who deal with them to help the IRS identify tax scofflaws and collect U.S. taxes. In a world of increasing globalization, who knows where FATCA's reach will end. □

Dean Paik, an attorney with nearly 30 years of experience, recently served as a top advisor to the Assistant Attorney General of the Tax Division, Dept. of Justice (DOJ) from 2010 to 2013. He advised on a variety of civil and criminal matters including the DOJ's overseas bank account initiatives. He helped devise strategies and policies on the enforcement against banks, bankers, and account holders of the laws requiring the disclosure of foreign bank accounts, including intergovernmental negotiations to resolve conflicts in bank secrecy laws so as to allow for the implementation of FATCA. He began his career as a trial attorney at the DOJ through the Attorney General's Honors Program prosecuting tax crimes and then served as an Assistant U.S. Attorney. Today, he is in private practice with the law firm Rogers Joseph O'Donnell in San Francisco and can be reached at 415-956-2828 or dpaik@rjo.com.

THE HISTORY OF MEDICARE

As Medicare enters its 50th year serving older Americans, let's take a look at the milestones that mark the evolution of this program, which has become the largest health care provider in our nation and supports longer, healthier lives and economic security for nearly 50 million Americans.

