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German Ministry of Finance view on US FATCA

http://docs.bepartners.pro/2015-11-03_informationstausch-USA-anwendungsschreiben-zu-FATCA-2.pdf

Following a six month long discussion with the German associations of banks and the investment management industry, the German Ministry of Finance issued an ordinance on the application of the rules under the Foreign Account Tax Compliance Act (FATCA) agreed between Germany and the United States and set forth in the intergovernmental agreement on FATCA (IGA) (the "Ordinance") on November 3, 2015. The discussion with the industry results in various amendments to the draft of the Ordinance previously published in June 2015. This Newsletter will specifically address the deviations to the draft Ordinance and addresses certain issues that have yet to be clarified by the German financial authorities.

In relation to the IGA dated May 23, 2013 and the Ordinance Regulating the Implementation of FATCA dated July 23, 2014 (Umsetzungsverordnung), the most important issue is whether a German entity qualifies as a financial institution (FI) or as an active or passive non-financial institution (NFFE) under the aforementioned legal framework. The German Ministry of Finance provides its view thereto in nos. 9 to 93 of the Ordinance, which is 71 pages long.

According to the German Ministry of Finance, the term "Financial Institutions" includes the following entities:

1. Custodial Institution

Entities that generate at least 20 % of their income by safekeeping financial assets and related financial services (e.g. handling fees, commissions, fees from securities transaction, lending fees or other consulting services) qualify as Custodial Institutions. Thus, depositary banks, trust companies and clearing houses, which safekeep the financial assets of their customers, will qualify as Custodial Institutions.

2. Depository Institution

Depository Institutions receive deposits from their customers as part of their general banking business or comparable activities, i.e. savings and loan, commercial banks, credit cooperatives, cooperative societies, or regulated trade and industrial cooperatives. A licence granted by the German regulatory authorities will support the qualification as a Depository Institution but is not mandatory for the qualification as a Depository Institution. This means that pre-paid credit card companies (that allow deposits of more than USD 50.000) may also qualify as Depository Institutions. Companies that provide asset-backed finance services (e.g. leasing business) or use the provided deposits only as security for the sale or the leasing of a property are not viewed as Depository Institutions. Factoring or leasing companies are thus generally excluded from the impact of FATCA.

3. Investment Entity

Investment Entities are defined as **financial service companies according the German Banking Act (KWG) or investment funds according to the German Capital Investment Act (KAGB)**. Moreover, the German Ministry of Finance's view is that companies not covered by the KWG or KAGB may also qualify as Investment Entities under FATCA if they trade in financial instruments, invest or manage financial assets of third parties. This results in a possible application of the FATCA rules to **holding companies or group finance companies** if these do not qualify as active or passive NFFEs. Unfortunately, the Ordinance does not provide any guidance on the treatment of **family offices** under FATCA.

Thus, capital management companies, internally managed investment entities and contractual investment entities (either investing in securities or real estate) qualify as Investment Entities under FATCA. However, investment funds subject to the KAGB are excluded from the reporting requirements under FATCA if they are entirely held by a Financial Institution, which itself is required to report under FATCA.

4. Re-insurance, casualty and health insurance companies are generally not impacted by FATCA

Since the qualification as a Financial Institution requires the existence of insurance or annuity contracts, which have a special value to be paid to the insured persons, only life in-

surance companies are impacted by FATCA. Moreover, insurance agents are not required to pay out the value from an insurance contract to the contract's beneficiary and therefore do not qualify as a Financial Institution.

5. Non-reporting FIs and exempt beneficial owners

Certain Financial Institutions, however, are excluded from the burdensome reporting requirements under FATCA if they qualify as so-called **"non-reporting Financial Institutions"** according the Annex II of the IGA or **"exempt beneficial owners"** under the US Treasury Regulations on FATCA.

The non-reporting Financial Institutions defined in Annex II of the IGA and the US Treasury Regulations are only those entities with a local customer base and local business. They are typically **small in size compared to the internationally active institutions**.

Exempt beneficial owners are **public entities** (such as public authorities, public schools, and universities, national health insurance schemes, chambers of commerce etc.), **the Deutsche Bundesbank**, **certain business development banks, international organizations** (EU or World Bank) and **pension funds** according to the US/German double tax treaty and in accordance with the ordinance issued on the definition of pension funds under the US/German treaty dated April 4, 2012. According to said ordinance, contractual trust agreements (CTA) are excluded as well.

Impact of FATCA on a non-financial foreign entity (NFFE)

NFFEs must disclose their FATCA status to Financial Institutions in order to enable the Financial Institutions to properly report their customer base under FATCA. If an NFFE does not do so, the Financial Institution has to notify the German Central Tax Office, which will inform the IRS accordingly that the NFFE is non-compliant. The non-compliant status of an NFFE results in a 30 % withholding tax penalty to be withheld by a US paying agent if the non-compliant NFFE does not fully disclose its FATCA status and delivers the relevant W-8 (US) tax form to the US paying agent prior to payment.

The self-certification of an NFFE requires the NFFE to distinguish between active and passive status of an NFFE. Active NFFEs do not have to disclose shareholders qualifying as a controlling US person, whereas passive NFFEs must do so. Annex I Section VI.B.4 of the IGA determines the criteria to be fulfilled by an active NFFE. Non-active NFFEs automatically qualify as passive NFFEs. From the various criteria set forth in Annex I (e.g. 50 % test, stock listing test, treatment of holding companies, regulation on companies during its set-up, liquidation or restructuring phase, etc.), the German Ministry of Finance provided its view only on the following criteria:

1. Active NFFE requires passive income < 50 %

The NFFE qualifies as active if less than 50 % if its gross income in the preceding calendar or business year consists of dividends, interest, rental income, royalties, income from derivatives or currency transaction as well as other profit distributions. Income from transactions with related parties only has to be considered if derived from the active business of the related party. The Ordinance does not give any guidance as to how this qualification is to be proven by the NFFE. Although the Ordinance stipulates that income within the meaning of the German Commercial Code should qualify as the gross income within the meaning of the IGA and the Ordinance Regulating the Implementation of FATCA dated July 23, 2014, one has to take into account that gross income is a specified term under US laws and thus German income terms may have to be reconciled accordingly. Due diligence procedures are therefore expected to be burdensome and will have to be properly documented.

2. Only certain holding companies do not qualify as NFFEs

According to the holding company definition in the IGA, the qualification depends on whether substantially all of the NFFE's activities consist of the **holding, financing and management of shares** in one or more subsidiaries that themselves do not qualify as Financial Institutions. In this context, the Ordinance only determines the term 'substantial'. If at least **80 % of the assets** of the holding company are held, financed and managed, this activity will qualify as substantial. Assets not only include an equity stake in the subsidiaries but any debt as well. Moreover, the Ordinance clarifies that shares in a subsidiary also cover comparable interests, i.e. not only corporations but also partnerships and other companies count as subsidiaries.

3. Investment Funds do not qualify as holding companies

According to Annex I of the IGA, holding companies acting as investment funds do not qualify as NFFEs but as Financial Institutions. This applies not only to private equity, venture capital and buy-out funds, but also to other investment fund structures that invest, hold and finance capital assets for investment purposes. However, the Ordinance does not provide any clarification on how to treat typical acquisition or management holding companies, which are usually used within alternative fund structures, and especially in structures where such companies are held by more than one shareholder.

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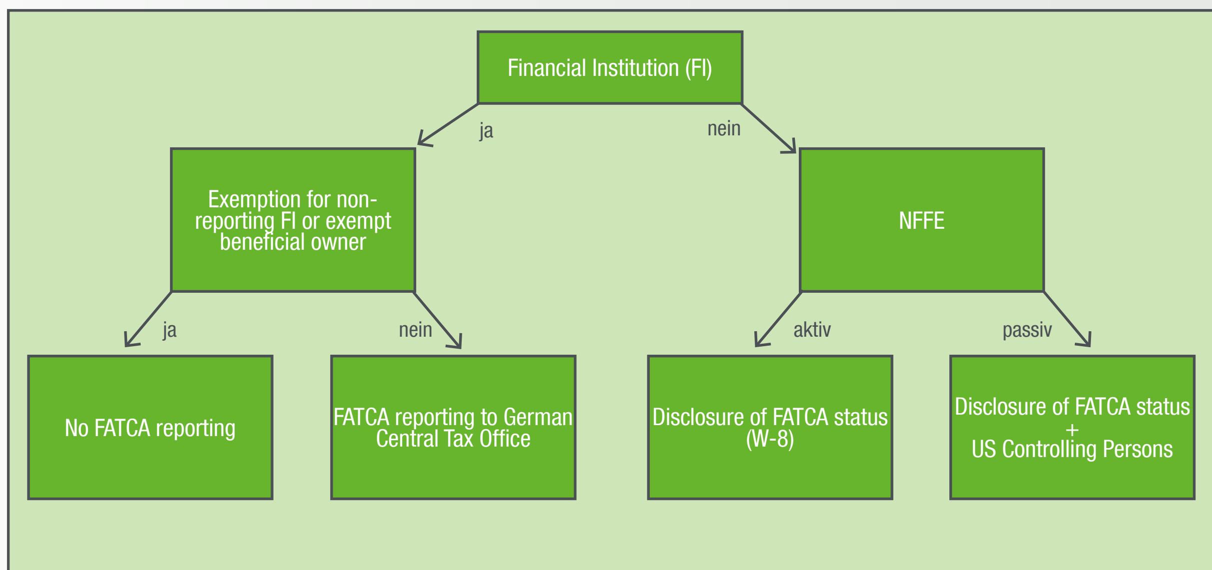
Conclusion:

Although the Ordinance provides guidance an a number of questions regarding the application of US FATCA to German entities, various issues, especially in regard to the qualification as a non-financial institution, remain unanswered. However, the status under FATCA is of significant importance for such entities as they will be accepted as customers by Financial Institutions only if these entities can fully and clearly disclose their FATCA status to the Financial Institutions. Hopefully, the active NFFE status will be clarified in more detail by the German financial authorities soon. We will keep you informed about any developments.

Following the approval of the law implementing the Common Reporting Standard (CRS) by the Upper House of the German Parliament, the law was signed and promulgated into the Federal Law Gazette (Bundesanzeiger) on December 30, 2015. As a result, the law entered into force on the day following its promulgation. Thus, the increased scope of financial information to be reported will result in information being reported not only to the US but to additional 56 countries in 2016 and to another 38 countries as of 2017.



be in touch: If you have any questions, please do not hesitate to contact us!

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