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Chile and Hungary Treaty Status Changes: Potential FATCA Impacts

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Changes to the statuses of the US-Chile Treaty and US-Hungary Treaty could have substantial FATCA implications for withholding agents, foreign financial institutions, and their counterparties, says Carson Le of KPMG LLP.

FATCA Intergovernmental Agreements (“IGAs”) between the United States and foreign jurisdictions are typically premised on the automatic exchange of information called for in the income tax treaties between the countries, and accordingly, changes to the status of a treaty can affect the status of the corresponding IGA. In light of recent changes to the statuses of the income tax treaties between the United States and Chile (“Chile Treaty”) and the United States and Hungary (“Hungary Treaty”), this article considers the potential impacts to the corresponding IGAs, as well the substantial FATCA implications such changes could have on residents of these countries as well as the counterparties they deal with.

Chile

The Model 2 IGA between the United States and Chile (“Chile IGA”) was signed in 2014, however the income tax treaty upon which the IGA is premised, signed in 2010, did not enter into force until December 19, 2023. Accordingly, FATCA obligations with respect to Chile have historically been based on the FATCA provisions of the U.S. Treasury Regulations (“Treas. Regs.”) rather than the terms of the IGA. While the IGA does not yet appear to be in force, it should soon be given that one of its primary purposes is to facilitate the exchange of information contemplated in the recently enacted treaty. Note that the U.S. Department of the Treasury maintains a list of FATCA IGAs and their respective statuses on its website (<https://home.treasury.gov/policy-issues/tax-policy/foreign-account-tax-compliance-act>). At the time this article was drafted, the list showed the Chile IGA as signed rather than in force.

Impacts on Chilean Financial Institutions. Because the Chile IGA has not yet gone into effect, compliant Chilean financial institutions are currently classified as Participating Foreign Financial Institutions

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("PFFIs") unless they qualify for a deemed-compliant status under the Treas. Regs. Once the IGA goes into effect, most PFFIs will likely become Reporting Chilean Financial Institutions under the IGA. A Reporting Chilean Financial Institution is a type of Reporting Model 2 FFI.

Changing from a PFFI to a Reporting Chilean Financial Institution should have minimal impact on a Chilean financial institution's existing FATCA reporting obligations given that both PFFIs and Reporting Model 2 FFIs are required to register with and report directly to the IRS, however some administrative steps may be needed to complete the transition. For example, Chilean financial institutions might need to cancel their existing PFFI registrations, complete new FATCA registrations as Reporting Model 2 Financial Institutions, and provide their counterparties with updated FATCA documentation. Ideally, the IRS will provide guidance that helps streamline the transition, but no such guidance has been published yet.

The IGA allows Chilean financial institutions to rely on deemed-compliant statuses from the Treas. Regs., and accordingly a financial institution that already qualifies for a deemed-compliant status still shouldn't need to report going forward. Given that Annex II of the IGA contains slightly different deemed-compliant statuses than the Treas. Regs., it's also possible that an entity that previously had reporting obligations as a PFFI will qualify for a newly available deemed-compliant status under the IGA, in which case it will no longer need to report once it adopts that deemed-compliance status.

Impacts on Account Holders of Chilean Financial Institutions. Certain entities that hold financial accounts with Chilean financial institutions may have additional classification options once the IGA goes into effect, as they may be able to continue classifying themselves under the Treas. Regs. or adopt a new status under the IGA. This generally includes any financial or nonfinancial Chilean account holder, as well as any nonfinancial account holder that resides in another jurisdiction. Financial institutions are generally classified for FATCA purposes based on the law applicable in the jurisdiction in which they reside, whereas nonfinancial entities are generally classified under the rules of the jurisdiction in which they hold a financial account.

Impacts on Financial Institutions with Chilean Account Holders or Withholding Agents with Chilean Payees. As noted above, the classifications available to Chilean entities will generally expand once the IGA goes into effect. Certain Chilean entities will be able to keep their current Treas. Regs. statuses if they choose, so financial institutions that maintain accounts for, and withholding agents that make payments to, Chilean entities shouldn't necessarily expect their FATCA statuses to change in all cases. When an entity's classification does change, however, any financial institution or withholding agent doing business with that entity should make sure its records and documentation are updated accordingly to avoid any potential withholding or reporting exposure. While an entity whose FATCA status changes has an obligation to notify its counterparties, financial institutions and withholding agents should be diligent in monitoring for changes in circumstances or other reasons to know that documentation currently on file is no longer reliable.

Hungary

The Hungary Treaty was terminated on January 8, 2023, which raised the possibility of termination of the Model 1 IGA between the countries ("Hungary IGA"). Shortly before termination of the treaty, however, the United States and Hungary entered into a Memorandum of Understanding clarifying that the Convention on Mutual Administrative Assistance in Tax Matters, executed in 1988, constitutes a

“successor Convention” that supports the exchange of information called for in the IGA. Accordingly, the Hungary IGA is expected to remain in force despite termination of the Hungary Treaty.

Although the Hungary IGA is expected to remain in force, the following paragraphs address potential FATCA impacts if the IGA does eventually terminate.

Impacts on Hungarian Financial Institutions. Hungarian financial institutions are typically classified based on the terms of the Hungary IGA. If the IGA is terminated, those financial institutions will no longer be able to rely on IGA classifications and will instead need to classify themselves under the Treas. Regs. The classifications adopted under the Treas. Regs. could have considerably different obligations.

For example, an entity currently classified as a Reporting Hungarian Financial Institution under the IGA may need to reclassify as a PFFI under the Treas. Regs. While a Reporting Hungarian Financial Institution and a PFFI are both required to register with the IRS to obtain a GIIN (Global Intermediary Identification Number, which is a unique identifier assigned by the IRS for FATCA purposes), a PFFI is also required to enter into an FFI Agreement with the IRS, file FATCA reports directly with the IRS, and submit periodic certifications of FATCA compliance to the IRS. This is a considerable expansion of substantive FATCA obligations.

In addition to expanding reporting obligations, transitioning from a Reporting Hungarian Financial Institution to a PFFI will likely involve substantial administrative steps. For example, impacted entities would likely need to cancel their existing FATCA registrations on the IRS portal and reregister as PFFIs, resulting in new GIINs being issued. Those entities would then need to provide updated FATCA documentation to any counterparties they continue to do business with, otherwise the counterparties would need to start treating them as Nonparticipating FFIs once their annual GIIN check revealed that the original GIINs provided were no longer valid, if not sooner.

Further, entities classified as Nonreporting Hungarian Financial Institutions under Annex II of the IGA would need to identify an applicable deemed-compliant status under the Treas. Regs. in order to avoid reporting obligations going forward. While there are substantial overlaps between the nonreporting statuses available under the IGA and the deemed-compliant statuses available under the Treas. Regs., certain Treas. Regs. statuses require IRS registration where the corresponding IGA classification does not. It’s also possible that a Nonreporting Hungarian Financial Institution would not qualify for any deemed-compliant status under the Treas. Regs. and therefore would need to become a PFFI in order to remain FATCA compliant.

Impacts on Account Holders of Hungarian Financial Institutions. Entities that hold financial accounts with Hungarian financial institutions and whose FATCA classifications are based on the IGA would need to reevaluate their FATCA classifications once the IGA is terminated. This generally includes any financial or nonfinancial Hungarian account holder, as well as any nonfinancial account holder that resides in another jurisdiction. Assuming the Hungarian Financial Institution that maintains the financial account would become a PFFI once the IGA was terminated, impacted account holders would need to determine their FATCA statuses with respect to those accounts under the Treas. Regs.

Impacts on Financial Institutions with Hungarian Account Holders or Withholding Agents with Hungarian Payees. As discussed above, Hungarian financial institutions would no longer be able to rely on IGA classifications if the IGA were terminated, and therefore a Reporting Hungarian Financial

Institution would eventually cease to be a valid FATCA classification. If that occurs, financial institutions that maintain financial accounts for, and withholding agents that make withholdable payments to, an entity historically classified as a Reporting Hungarian Financial Institution would expect to receive updated documentation that reflects the entity's new FATCA status.

Withholding agents and financial institutions will be treated as knowing that an entity is not a PFFI or registered deemed-compliant FFI on the earlier of the date that they discover that the FFI has been removed from the IRS GIIN list or one year from the date the FFI was actually removed from the list. If the IRS notifies a withholding agent or financial institution that a person's claimed status is incorrect, however, the withholding agent or financial institution will be treated as knowing the claimed status is incorrect beginning 30 days after such notice is received. Accordingly, withholding agents and financial institutions should monitor for notices from the IRS, whether sent through the IRS FATCA portal or other means, to ensure they remain compliant with their own FATCA withholding and reporting obligations.

The FATCA impacts discussed above would apply similarly with respect to other jurisdictions where a Model 2 IGA enters into force or a Model 1 IGA terminates.

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