

A Look at South Korea's FATCA Implementing Regulations

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PRACTITIONERS' CORNER

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The U.S. Treasury Department announced on April 2, 2014, that it had agreed in substance to an intergovernmental agreement with South Korea. The South Korean IGA has not been executed, and the text of the IGA has not yet been released. In the interim, under Announcement 2014-17, 2014-18 IRB 1001, taxpayers can treat the Model 1 IGA as being in effect in South Korea.

Although the South Korean IGA is not yet available, on June 18, 2014, South Korea's Financial Services Commission (FSC) released implementation rules for the South Korean IGA (the implementing regulations). The FSC has not published an official English translation of the regulations. The implementing regu-

lations are one of the first sets of published local Foreign Account Tax Compliance Act guidance that we have seen from IGA jurisdictions in Asia.

Financial Institutions Subject to FATCA

Consistent with the Model 1 IGA, the implementing regulations define a financial institution as a custodial institution, depository institution, investment entity, or specified insurance company. Unlike under rules issued by the United Kingdom and Ireland, the implementing regulations do not specifically treat holding companies or treasury centers as a category of financial institution.

Under the implementing regulations, only a "domestic financial institution" can be a "reporting financial institution." The regulations generally define a domestic financial institution as a financial institution that falls under one of 12 different categories — including banks organized under South Korea's Banking Act or investment businesses regulated under South Korea's Financial Investment Services and Capital Markets Act — or a custodial institution, depository institution, investment entity, or specified insurance company not specifically described in one of the 12 categories.¹

South Korean reporting financial institutions are required to comply with the registration requirements described on the IRS online portal. A South Korean reporting financial institution also must report its IRS-issued global intermediary identification number as

¹It does not appear that the domestic financial institution concept is intended to narrow the scope of financial institutions under the implementing regulations. This is in contrast to implementing legislation issued by Canada.

well as its South Korean corporate registration number to South Korea's National Tax Service by January 15, 2015, or a month after the entity registers, whichever is later.

The following discussion provides more detail on how the implementing regulations define a financial institution.

Custodial Institution

Consistent with the Model 1 IGA, a custodial institution is generally defined as an entity whose gross income attributable to the holding of financial assets and related financial services equals or exceeds 20 percent of the entity's gross income in the previous three years. Unlike the Model 1 IGA, the implementing rules elaborate on what types of services count for purposes of the 20 percent test:

- commission fees for custodial services, account management, and wire transfers;
- commission fees for execution and pricing;
- commission fees for securities trading;
- profits from making loans to clients;
- profits trading in stocks and other financial assets;
- commission fees for providing investment consulting and settlement services; or
- financial services similar to those described above.

The implementing regulations exclude from the definition of custodial institution any trusts (as defined in South Korea's Financial Investment Services and Capital Markets Act) that hold financial assets on behalf of others.

Depository Institution

Under the Model 1 IGA, a depository institution means any entity that accepts deposits in the ordinary course of a banking or similar business. Under the implementing regulations, a banking or similar business includes providing any of the following services:

- making loans;
- discounting promissory notes; or
- conducting foreign exchange transactions.

The implementing regulations do not provide an exception for entities that accept deposits solely as collateral or security.²

² See Treas. reg. section 1.1471-5(e)(2)(ii).

Investment Entity

The Model 1 IGA defines an investment entity as an entity that conducts as a business (or is managed by an entity that conducts as a business) specific investment-type activities for or on behalf of a customer. The Model 1 IGA lists three types of activities:

- trading in specific financial instruments;
- portfolio management; or
- otherwise investing, administering, or managing funds or money on behalf of other persons.

The implementing regulations generally list the same three types of activities. However, in contrast to the Model 1 IGA, the implementing regulations add that income generated from any of the three types of activities must constitute over 50 percent of the gross income of the entity over the previous three years in order for it to be classified as an investment entity.

Specified Insurance Company

Finally, the implementing regulations provide that a specified insurance company means an entity that issues cash value insurance or annuity contracts.

Deemed-Compliant Status

Consistent with Annex II of the Model 1 IGA, the implementing regulations treat the following types of entities as deemed compliant: financial institutions with a local client base, local banks, trustee-documented trusts, sponsored investment entities and controlled foreign corporations, sponsored closely held investment vehicles, investment advisers and investment managers, and collective investment vehicles. The definitions in the implementing regulations generally follow the Model 1 IGA. The implementing regulations also contain a deemed-compliant category for restricted funds.

Interaction With South Korean IGA

Because the implementing regulations have been issued before the South Korean IGA has been executed, it is possible that some provisions in the implementing regulations may conflict with the IGA. The implementing regulations provide that in the case of conflict, the IGA text will override the implementing regulations. ◆