

Proposed FATCA Regulations Issued by the Treasury Department

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On February 8, 2012, the Treasury Department released long-awaited proposed regulations providing guidance on the information reporting, due diligence and withholding requirements under the Foreign Account Tax Compliance Act (“FATCA”). While FATCA remains potentially costly and burdensome to affected entities, the proposed regulations take a number of important steps in response to comments from practitioners and industry participants that will ease compliance with the FATCA rules.

Background

In response to the use of offshore accounts and foreign bank secrecy laws by some U.S. taxpayers to evade U.S. tax on their income, FATCA was enacted in 2010, with a delayed effective date in order to allow time for the government to promulgate detailed rules and financial institutions and other affected parties to develop systems for compliance. The FATCA rules impose a 30% withholding tax on payments to certain foreign entities of U.S. source “FDAP” income and gross proceeds from the disposition of property that produces U.S. source interest or dividends, as well as “passthru” payments attributable to such amounts made by certain foreign persons to other parties.¹ The FATCA rules apply differently to so-called foreign financial institutions, or “FFIs” (a term which includes foreign banks, brokerage firms, and investment funds and certain other foreign entities), and non-financial foreign entities, or “NFFEs.” An FFI generally is subject to the 30% withholding tax unless it becomes a “participating FFI” by entering into an agreement with the IRS requiring it to undertake diligence procedures intended to identify accounts that belong to U.S. persons, to comply with certain information reporting requirements, and to withhold 30% of any passthru payments that it makes to “recalcitrant” account holders who refuse to provide information with respect to their possible status as U.S. account holders or to nonparticipating FFIs. NFFEs generally are subject to the 30% withholding tax unless they certify as to the identity of their substantial U.S. owners.

Prior to issuance of the proposed regulations, preliminary guidance on FATCA was provided in the form of a series of IRS notices.² The proposed regulations largely implement the guidance contained in these notices, but they also ease some of the rules in the notices, delay the effective dates of some of the more burdensome requirements of FATCA, and provide guidance on some issues that were not addressed in the notices.

Government-to-Government Information Exchanges

Simultaneously with issuance of the proposed regulations, the Treasury Department and governmental authorities in France, Germany, Italy, Spain and the United Kingdom made a joint announcement that they would attempt to implement an alternative government-to-government framework for implementing FATCA with respect to FFIs located in those countries. Under this approach, FFIs located in the foreign countries would be allowed to report information to their own governments rather than entering into agreements with the IRS, and the U.S. would enter into enhanced information sharing agreements with the foreign governments. FFIs in those countries would be relieved of the burden of terminating accounts of or withholding U.S. tax from passthru payments made to recalcitrant account holders. We anticipate that as the basic FATCA regime is phased in, the Treasury Department will aggressively seek to expand its network of intergovernmental information sharing beyond the original five identified countries.

Highlights of the Proposed Regulations

Expanded Scope of Grandfathered Obligations

Under the statute, payments with respect to obligations issued and outstanding on or before March 18, 2012 are exempt from the FATCA withholding regime. The proposed regulations extend this relief to obligations outstanding on January 1, 2013.

¹ FDAP refers to fixed or determinable annual or periodical income and encompasses a very broad category of income including items such as dividends, interest, rents and royalties.

² Notice 2010-60, 2010-37 IRB 329 (Aug. 27, 2010); Notice 2011-34, 2011-19 IRB 765 (Apr. 8, 2011); 2011-53, 2011-32 IRB 124 (July 14, 2011).

Transitional Rules for FFIs with Affiliates Prohibited from Complying

The Treasury Department has acknowledged that compliance with FATCA may be prohibited under the law in effect in the jurisdiction where an FFI operates. The proposed regulations provide a two-year transition period through the end of 2015 during which an FFI will not be prevented from being a participating FFI because one of its affiliates is prohibited by the laws of its jurisdiction from complying with FATCA, provided that the FFI affiliate in question agrees to perform due diligence to identify its U.S. accounts, maintain certain records and satisfy certain other requirements.

Expanded Categories of Foreign Financial Institutions Deemed Compliant

Under IRS Notice 2011-34, certain FFIs would be deemed compliant with the FATCA requirements and therefore not required to enter into a formal agreement with the IRS in order to receive payments of U.S. source FDAP, gross proceeds and passthru payments free of withholding tax under FATCA. The proposed regulations provide an expanded list of categories of deemed-compliant institutions that are not likely to have U.S. owners or account holders, including certain local banks, investment funds and affiliates of participating FFIs that register with the IRS and satisfy certain requirements, as well as certain small and local banks, charities and retirement funds that would be allowed to self-certify their qualification without registering with the IRS.

Expanded Categories of Non-Financial Foreign Entities Exempt from FATCA

The proposed regulations expand the types of NFFEs that are exempt from withholding tax and information reporting under FATCA. Exempt NFFEs include certain publicly traded companies and their affiliates, NFFEs predominantly engaged in active businesses, and nonfinancial holding companies.

Modification of Due Diligence Procedures

Under FATCA, participating FFIs are required to perform due diligence on accounts to identify indicia of U.S. ownership. The proposed regulations provide different standards for preexisting accounts and accounts opened after the effective date of a participating FFI's agreement with the IRS. The proposed regulations generally are more lenient in this regard than the prior notices, including permitting greater reliance on FFIs' existing anti-money laundering and know your customer procedures. The proposed regulations eliminate heightened scrutiny for accounts under the broad rubric of "private banking," and instead rely on a \$1,000,000 threshold for heightened scrutiny.

Guidance on Procedures Required to Verify Compliance

The regulations provide that third-party audits of participating FFIs' FATCA compliance will not be required and that a responsible officer of the FFI can certify its compliance with the terms of its agreement.

Redefined Definition of "Financial Account"

The proposed regulations modify the definition of "financial account" to focus on traditional bank, brokerage and money market accounts and interests in investment vehicles. Excluded from this definition are most debt and equity securities issued by banks and brokerage firms, subject to an anti-abuse rule.

Extension of the Transition Period for Scope of Information Reporting

The proposed regulations provide that reporting by participating FFIs of income of U.S. accounts would begin in 2016 (with respect to the 2015 calendar year), and reporting on gross proceeds would begin in 2017 (with respect to the 2016 calendar year). Reporting with respect to calendar years 2013 and 2014 would be limited to reporting with respect to recalcitrant account holders and identification of U.S. account holders (including names, addresses, and taxpayer identification numbers) and their account balances. With respect to the 2013 calendar year, reporting would be required by September 30, 2014 with respect to accounts identified as of June 30, 2014. The proposed regulations would permit FFIs to elect to report information either in the currency in which the account is maintained or in U.S. dollars.

Passthru Payments

The proposed regulations provide that withholding will not be required with respect to foreign source passthru payments paid to nonparticipating FFIs and recalcitrant account holders by participating FFIs before January 1, 2017. Withholding on passthru payments prior to January 1, 2017 will be limited to payments by participating FFIs of U.S. source FDAP, such as payments of interest or dividends on U.S. securities held by participating

FFIs on behalf of customers. The proposed regulations require participating FFIs to make annual reports to the IRS regarding the aggregate amount of FDAP and other financial payments to be specified in future guidance made to each nonparticipating FFI with respect to calendar years 2015 and 2016.

The proposed regulations reserve on detailed rules for imposing withholding tax on foreign source passthru payments by participating FFIs to nonparticipating FFIs and recalcitrant account holders beginning in 2017. The notices had included complicated rules for determining the extent to which passthru payments, such as payments on interest bearing accounts and dividends made by an FFI, are treated as attributable to U.S. source FDAP and gross proceeds from the disposition of U.S. source interest and dividend producing property received by the participating FFI and thus subject to withholding. The IRS has requested additional comments on ways in which to ease the burden of compliance with the withholding requirement once it becomes effective.

Timeline

At the end of this document is a non-exhaustive timeline outlining some of the critical dates under the proposed regulations. Please note that as the regulations are currently in proposed form, these dates remain subject to further revision by the Treasury Department and IRS.

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KEY FATCA IMPLEMENTATION DATES

2013	<p><u>1/1/2013</u> Last day by which obligations must be outstanding to qualify as grandfathered obligations to which FATCA withholding does not apply.</p>
2014	<p><u>1/1/2014</u></p> <ul style="list-style-type: none"> • 30% withholding applies to payments of U.S. source FDAP to a nonparticipating FFI or a nonexempt NFFE that does not certify as to its substantial owners. • Participating FFIs must withhold 30% of “passthru” payments of U.S. source FDAP to recalcitrant account holders and nonparticipating FFIs.
2015	<p><u>9/30/2014</u></p> <ul style="list-style-type: none"> • Participating FFIs must report with respect to U.S. accounts and accounts of recalcitrant account holders identified as of June 30, 2014. • Participating FFIs required to report with respect to the 2013 calendar year (i) name, address and TIN of U.S. account holders and each substantial owner of U.S. owned NFFEs; (ii) account balance or value at the end of the calendar year; and (iii) account number.
2015	<p><u>1/1/2015</u> Gross proceeds paid to a nonparticipating FFI or a nonexempt NFFE that does not certify as to its substantial owners from the sale or disposition of any property that may produce U.S. source interest or dividend income become subject to 30% withholding.</p>
2016	<p><u>3/31/2015</u> Participating FFIs required to report with respect to the 2014 calendar year (i) name, address and TIN of U.S. account holders and each substantial owner of U.S. owned NFFEs; (ii) account balance or value at the end of the calendar year; and (iii) account number.</p>
2016	<p><u>1/1/2016</u></p> <ul style="list-style-type: none"> • A Qualified Intermediary that cannot comply with an FFI agreement may no longer retain its status as a QL. • The grace period for FFI branches and affiliates prohibited from complying with FATCA due to local law restrictions terminates
2017	<p><u>3/15/2016</u> Participating FFIs must begin annual reporting beginning with calendar year 2015 of payments of FDAP income and “other financial payments” during the prior calendar year to nonparticipating FFIs on a payee-specific basis.</p>
2017	<p><u>3/31/2016</u> Participating FFIs’ information reporting obligation for calendar year 2015 expanded to include all payments made with respect to U.S. account holders (other than the gross proceeds from a sale or redemption of property credited to certain custodial accounts).</p>
2017	<p><u>1/1/2017</u> FFIs will generally be required to withhold tax from “passthru” payments made to recalcitrant account holders or nonparticipating FFIs.</p>
2017	<p><u>3/31/2017</u> Participating FFIs’ information reporting obligation with respect to U.S. account holders for calendar year 2016 expanded to include gross proceeds from dispositions of property.</p>

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