Final FATCA Regulations Issued by the Treasury Department

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On January 17, 2013, the United States Treasury Department released final regulations (the "Final Regulations") under the Foreign Account Tax Compliance Act ("FATCA"). The Final Regulations largely follow the proposed regulations issued last February with certain clarifications made in response to industry and practitioners' comments and additional modifications meant to liberalize the requirements of the proposed regulations and provide transitional period relief. The Final Regulations attempt to balance the competing objectives of implementing FATCA and easing the transition by imposing less strict early diligence and reporting burdens on persons and circumstances deemed to be low-risk. Despite the Treasury Department's helpful clarifications and efforts to simplify the implementation of FATCA, the Final Regulations are complex and retain the principal elements of the FATCA regime that will impose substantial compliance burdens on affected persons. This alert summarizes some of the highlights of the Final Regulations and is not intended to be a comprehensive summary.

Background

FATCA was enacted in 2010 in response to the use of offshore accounts and bank secrecy laws by some U.S. taxpayers to evade U.S. tax. FATCA imposes a 30% U.S. withholding tax on payments to certain foreign entities of U.S. source FDAP[1] income and proceeds from the disposition of property that produces U.S. source interest or dividend income, as well as certain "passthru" payments of such amounts by foreign persons to other parties. The FATCA rules apply differently to so-called foreign financial institutions, or "FFIs" (a term which includes foreign banks, investment funds and certain other foreign entities), and non-financial foreign entities, or "NFFEs". Payments to an FFI generally are subject to the 30% tax unless the FFI enters into an agreement with the IRS to comply with certain enhanced information reporting and diligence procedures intended to identify accounts that belong to U.S. persons.[2] In addition to complying with the reporting and diligence procedures, a participating FFI is required to withhold 30% of any "passthru" payments that it makes to "recalcitrant" account holders or nonparticipating FFIs. Payments to a non-excepted NFFE whose income is primarily passive generally are subject to the 30% tax if the NFFE fails to identify its substantial U.S. owners.

Highlights of the Final Regulations

Expanded Scope of Grandfathered Obligations

The Final Regulations extend relief from FATCA withholding (including gross proceeds withholding on sales) to all obligations outstanding on January 1, 2014 and all payments made with respect to collateral securing such obligations.

Obligations are treated as outstanding for this purpose on the date a binding agreement is executed, so that revolving credit agreements and delayed draw facilities executed by December 31, 2013 will qualify for grandfathering. Debt issued pursuant to a qualified reopening will be treated as outstanding on the issue date of the original debt being reopened.

The Final Regulations also provide grandfather relief for obligations that may give rise to withholdable "dividend equivalent" payments, such as total return swaps, or to foreign passthru payments, if they are outstanding within the six months after Treasury Regulations implementing the dividend equivalent and foreign passthru payment rules are published.

Definition of Foreign Financial Institution

The Final Regulations include important guidance on the characterization of entities for purposes of the FATCA rules.

Investment Entities.

Foreign entities that invest, manage or administer funds, money or financial assets on behalf of customers are treated as FFIs under the Final Regulations.

Entities whose gross income is primarily derived from investing or trading in financial assets but that do not hold themselves out as private equity funds, hedge funds or similar investment vehicles are treated as NFFEs rather than FFIs unless they are managed by financial institutions. For example, a family trust will be an NFFE if it is managed by an individual trustee but will be an FFI if the trustee is a trust company or its investments are otherwise managed by a financial institution.

A new rule permits investment fund managers to register as "sponsoring entities" responsible for due diligence, withholding and reporting on behalf of investment entities that they manage.

Holding Companies and Treasury Centers.

Financial entities and passive NFFEs that are part of a nonfinancial group of companies and support the operations of the group (e.g., a holding company, captive insurance company or a treasury center of a multinational group) generally are treated as NFFEs that are exempt from FATCA withholding. However, holding companies formed in connection with or availed of by private equity funds, hedge funds and similar investment funds are treated as FFIs.

Deemed Compliant FFIs

The Final Regulations expand and modify the categories of FFIs treated as "deemed compliant" and therefore exempt from the requirement to enter into an agreement with the IRS. Specifically, the Final Regulations:

- expand the definition of "local FFIs," which generally consist of banks and similar financial institutions that do not operate or solicit customers outside of their home country;
- expand the categories of "deemed compliant" investment funds that are regulated in their home country and subject to ownership limitations, known as "qualified collective investment vehicles" and "restricted funds;"
- create a new category of deemed compliant FFIs for credit card issuers that accept deposits only in limited circumstances and in amounts no greater than $50,000; and
- create a temporary category of deemed compliant entities to provide relief to debt investment vehicles (such as collateralized debt obligation funds) in order to allow the investors and trustee to amend the governing documents to permit compliance.

Extension of Effective Dates for Withholding

Withholding on payments to nonparticipating FFIs and non-excepted NFFEs generally is required on payments on or after January 1, 2014 unless the relevant obligation is grandfathered.

Withholding on the payment of gross proceeds from the disposition of property is delayed until January 1, 2017.

Participating FFIs are not required to withhold on foreign passthru payments until the later of January 1, 2017 or six months after the date on which Treasury Regulations governing foreign passthru payments are published.

Reduction of Due Diligence Burdens

Participating FFIs generally are required to file their first information reports on March 31, 2015 for the 2013 and 2014 calendar years.

The Final Regulations extend the verification deadline for most pre-existing accounts, which now include all accounts maintained prior to January 1, 2014 (or the effective date of the FFI agreement) and new accounts of preexisting customers, until December 31, 2015, unless the account is held by a prima facie FFI or is an individual account with a value in excess of $1 million. Participating FFIs must review prima facie FFI accounts by the later of June 30, 2014 or six months after its FFI agreement is effective and high value individual accounts by the later of December 31, 2014 or one year after the effective date of the FFI agreement.

The Final Regulations provide an exemption from review for preexisting individual accounts with a balance of $50,000 or less, preexisting entity accounts with a balance of $250,000 or less and preexisting insurance contracts with a balance or value of $50,000 or less.

In the case of preexisting accounts with a balance or value of $1 million or less, a participating FFI may make its determinations of whether individuals' accounts are U.S. accounts solely on the basis of electronically searchable account information. In most cases, participating FFIs may rely on IRS Forms W-8 and W-9 for due diligence (including pre-FATCA forms with respect to preexisting accounts), employ alternative forms of documentation that provide sufficient information and may use the so-called "eyeball test" to treat as U.S. persons entities whose names include the word "incorporated" or "corporation" in the case of payments made inside the United States. The Final Regulations also permit documentation to remain valid indefinitely for certain low-risk "deemed compliant" FFIs.

Withholding agents that acquire accounts through a merger or bulk acquisition from a U.S. withholding agent or a participating FFI are given a six-month period during which they can rely on determinations made by the predecessor regarding account holders' statuses.

The FATCA Registration Portal

The IRS will establish a secure web-based FATCA Registration Portal intended to expedite and facilitate interactions between FFIs and the IRS. An FFI will be able to access the portal to complete its registration as a participating FFI, execute an agreement to comply with its obligations, obtain a Global Intermediary Identification Number ("GIIN") and satisfy its reporting obligations under FATCA. The FATCA Registration Portal is expected to be accessible no later than July 15, 2013. An FFI generally will need to obtain a GIIN in order to identify itself to withholding agents as a participating FFI and all FFIs governed by Model 1 IGAs, as discussed below, will be required to obtain GIINs.

The IRS will produce a list of participating FFIs and registered deemed-compliant FFIs that will be published electronically beginning December 2, 2013. FFIs must register by October 25, 2013 in order to be included on the initial list.

Intergovernmental Agreements

After the proposed FATCA regulations were released, the Treasury Department introduced two model intergovernmental agreements ("IGAs") to facilitate the implementation of FATCA and promote the Treasury Department's agenda of enhanced international information sharing. Under the first model (a "Model 1 IGA"), an FFI reports information directly to the government in its country of residence rather than to the IRS. The relevant country is responsible for exchanging information with the IRS.

The second model (a "Model 2 IGA") requires an FFI to report information to the IRS and this information is supplemented in the case of certain recalcitrant account holders by the government in the FFI's country of residence. Under the Model 2 IGA approach, the FFI is required to comply with the Final Regulations except to the extent modified by the Model 2 IGA. IGAs have already been executed between the United States and Denmark, Ireland, Mexico and the United Kingdom; agreements with Norway, Spain and Switzerland are awaiting signature and more than 40 countries are currently in discussions with the IRS regarding IGAs. With the exception of the IGA between the United States and Switzerland, all of the announced IGAs are Model 1 IGAs.

Timeline

Attached hereto is a non-exhaustive timeline outlining some of the critical dates under the Final Regulations.

1. FDAP refers to fixed, determinable, annual and periodic income and encompasses a very broad category of income including items such as dividends, interest, rents and royalties.
2. An FFI that agrees to comply with the reporting and diligence procedures is referred to as a "participating FFI," and an FFI that does not so agree, a "nonparticipating FFI."

For more information on the subject of this advisory or Hughes Hubbard's tax practice, please contact any of the following attorneys:

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