

# U.S. Tax Authorities Issue Final FATCA Regulations

**January 25, 2013**

On January 17, 2013, the U.S. Department of the Treasury (Treasury Department) and U.S. Internal Revenue Service (IRS) issued final Treasury Regulations (Final Regulations) under the tax provisions commonly referred to as the Foreign Account Tax Compliance Act (FATCA).[\[1\]](#)

With the issuance of the Final Regulations, taxpayers and other affected stakeholders have increased clarity regarding the application of FATCA to affected transactions, and affected financial institutions can move forward with greater certainty in implementing FATCA compliance. The Final Regulations also amend in important ways certain provisions of the proposed regulations under FATCA issued in February 2012 (Proposed Regulations) and take into account the effect of existing and anticipated intergovernmental agreements (IGAs) between the U.S. and foreign governments. However, notwithstanding the issuance of the Final Regulations, the FATCA statutory rules, the IGA framework and the Final Regulations implementing both, will remain an ongoing and significant challenge for tax compliance professionals worldwide.

Read this client alert for a summary of critical dates in FATCA implementation (some of which have been modified by the Final Regulations), followed by a discussion of significant aspects of the Final Regulations, particularly how they vary from, and add to, the rules promulgated in the Proposed Regulations relating to the scope of FATCA and the applicability of FATCA withholding tax to payments made by and to foreign entities.

[\[2\]](#)

Background

The Treasury Department and the IRS have stated on numerous occasions that the principal policy objective of FATCA is to combat, through increased information reporting, U.S. tax evasion that the U.S. government believes is the result of the use of offshore accounts by U.S. taxpayers. To this end, FATCA generally requires foreign financial institutions (FFIs) and certain other foreign entities to undertake diligence to identify U.S. accounts, and report certain information to the IRS with respect to such U.S. accounts, or suffer a 30% U.S. withholding tax on certain U.S.-source payments (Withholdable Payments) and "passthru" payments (Passthru Payments) that such foreign entities receive.

As described in the preamble to the Final Regulations (Preamble), the Treasury Department and the IRS used a "risk-based" approach in crafting the Final Regulations, which (although not defined) appears to mean that the Treasury Department and the IRS attempted to calibrate compliance burdens under FATCA according to the risk and extent of potential tax evasion. For example, the Final Regulations generally impose reduced obligations with respect to low value accounts and modify the scope of entities that will be treated as FFIs and "deemed-compliant FFIs." At the same time, however, the Treasury Department and the IRS reaffirm in the Preamble their belief that financial institutions (both in the U.S. and abroad) are generally in the best position to identify and report with respect to their U.S. customers. This suggests that the Treasury Department and the IRS believe that, given the types of entities that FATCA attempts to regulate, complexity is inevitable and taxpayers and other affected stakeholders should not expect the Final Regulations to provide a set of simple rules.

The Final Regulations are a voluminous set of rules comprised of hundreds of pages of details regarding the implementation of all aspects of FATCA. The Final Regulations are relevant to private investment funds of all types, fund managers and investors, banks, custodians, insurance companies, retirement funds, foreign governments and the investment entities they directly or indirectly control, service providers who will assist in facilitating FATCA compliance and many other members of the global financial services community.

#### Certain Key FATCA Dates

The following is a list of certain key dates with respect to the implementation of FATCA:

- **October 25, 2013**

- *Registration.* It is expected that the IRS will open for FATCA registration for FFIs by July 15, 2013. An FFI required to register with the IRS must do so by October 25, 2013 to ensure that it is properly reflected on a list to be published by the IRS by the time actual FATCA withholding commences on January 1, 2014. As discussed below, the Preamble announces that the IRS will launch a secure online FATCA Registration Portal, allowing for a paperless registration process.

- **January 1, 2014**

- *Withholding on U.S.-source Fixed, Determinable, Annual or Periodical Income (FDAP) Begins.* Withholding on Withholdable Payments consisting of U.S.-source dividends, interest and certain other income is required commencing January 1, 2014 for new accounts opened on or after January 1, 2014 if the documentation required by FATCA is not provided by the account holder.
- *New Account Opening Procedures Effective.* Withholding agents generally are required to implement the new account opening procedures prescribed in the Final Regulations by January 1, 2014.
- *Grandfathered Obligations.* Payments with respect to certain "grandfathered obligations" will not be subject to FATCA withholding (changes to the definition of "grandfathered obligation" adopted in the Final Regulations are discussed below). New obligations issued after January 1, 2014 are not "grandfathered obligations."

- **July 1, 2014**

- *Due Diligence on Preexisting Obligations; Withholding on Prima Facie FFIs.* The deadlines for withholding agents to document the FATCA status of account holders with respect to "preexisting obligations" (generally, any account, instrument, contract, debt or equity interest maintained, executed or issued by the withholding agent that is outstanding on December 31, 2013) vary depending upon the type of withholding agent, the type of account holder and, in certain cases, the value of the account. The dates withholding under FATCA is required to commence are related to the dates documentation of account holders is required to be completed. The earliest deadline for documenting account holders is for "preexisting obligations" held by "prima

facie FFIs" where withholding is required with respect to U.S.-source FDAP beginning July 1, 2014 if the documentation required by FATCA has not been provided by the FFI.

- **March 31, 2015**

- *Filing of FATCA Information Reports Begins.* The first deadline for "participating FFIs" to file information reports with the IRS is March 31, 2015 (covering both 2013 and 2014). Annual FATCA reporting will be done on new IRS Form 8966 (FATCA Report), which the Preamble announces that the IRS will release in the near future.

- **January 1, 2017**

- *Gross Proceeds Withholding.* Withholding on Withholdable Payments that consist of gross proceeds from the disposition of property that can produce U.S.-source interest or dividends is required commencing on January 1, 2017.
- *Foreign Passthru Payments.* Withholding on "foreign passthru payments" (on which the definition of which the Final Regulations continue to reserve in its entirety) will not be required until the later of January 1, 2017 or the date which is six months after the publication of final regulations defining the term "foreign passthru payments."

Major Developments in the Final Regulations on the Scope of FATCA and Applicability of FATCA to Payments Made to Foreign Entities

*Interaction of Final Regulations and IGAs*

As noted above, the Treasury Department has developed an alternative intergovernmental approach to achieving the policy goals of FATCA, while addressing impediments to FATCA compliance under the laws of other countries, and enhancing general intergovernmental information exchange. To accomplish these goals, the Treasury Department has developed two model IGAs (Model 1 IGA and Model 2 IGA) that may be entered into between the U.S. and a non-U.S. jurisdiction (Partner Jurisdiction).

The principal difference between the two model IGAs is that the Model 1 IGA contains an agreement by the Partner Jurisdiction to adopt local laws for non-exempt FFIs in the jurisdiction to identify and report information about U.S. accounts to the Partner Jurisdiction tax authority, and then the Partner Jurisdiction tax authority will on-report the information to the IRS. Under the Model 2 IGA, on the other hand, a Partner Jurisdiction agrees to direct and enable all non-exempt FFIs in the jurisdiction to register with the IRS and report information regarding their U.S. accounts directly to the IRS, but generally will not require direct local law reporting. Accordingly, any legal impediment to an FFI reporting information regarding its U.S. accounts is resolved by an IGA because the Partner Jurisdiction has expressly agreed to allow such reporting.

The Final Regulations contemplate that, if an FFI is covered by a Model 1 IGA and that FFI complies with the Partner Jurisdiction's local laws with respect to U.S. account identification and reporting in accordance with the terms of that Model 1 IGA, that FFI will be treated as satisfying all of the FATCA due diligence and reporting requirements in their entirety, without applying the Final Regulations for purposes of avoiding FATCA withholding tax.[\[3\]](#) As a practical matter, FFIs that are covered by a Model 2 IGA will be required to comply with the Final Regulations except to the extent specifically modified by the IGA.

The U.S. has entered into (or has pending) IGAs based on the Model 1 IGA with Denmark, Ireland, Mexico, Norway, Spain and the United Kingdom, and has entered into an IGA based on the Model 2 IGA with Switzerland. It is widely expected that many other jurisdictions will enter with the U.S. into IGAs generally conforming to one or the other model in the near future (e.g., the U.S. has been in negotiations with the Cayman Islands) and the Preamble notes that the Treasury Department and the IRS believe that IGAs represent an efficient and effective method to implement the requirements of FATCA.

It is important to note, however, that the IGAs represent bilateral agreements between governments, and as a result potentially are subject to interpretive issues that potentially are not contemplated by the Final Regulations or by the plain text of the IGAs (e.g., issues regarding establishing whether a financial institution is covered by an IGA).

Additionally, an FFI that is within the scope of an IGA generally will be required to comply with the local law implementing the IGA, whether or not the FFI has any U.S. connections. This will lead to a somewhat different posture for FFIs covered by an IGA than for those covered solely by FATCA, since under FATCA an FFI can elect not to comply with FATCA (and suffer the imposition of FATCA withholding tax) if the risk of FATCA withholding tax being imposed in such an FFI's particular circumstances is judged to be low.

#### *FATCA Registration – Timeline and Process*

In order to comply with the FATCA rules prescribed by the Final Regulations (and thus receive Withholdable Payments without reduction for the 30% FATCA withholding tax), certain categories of FFIs will be required to affirmatively provide information and certifications to the IRS, as well as enter into a binding agreement with the IRS to comply with the due diligence and information reporting requirements of the Final Regulations pursuant to an "FFI Agreement." The Preamble states that, in order to allow for efficient registration and reporting, a secure online FATCA Registration Portal (FATCA Portal) is being developed by the IRS that will enable FFIs to register with the IRS in a paperless registration process, enter into an FFI Agreement to the extent applicable and make the periodic certifications required by the Final Regulations.

The Preamble states that the FATCA Portal is expected to be accessible no later than July 15, 2013. The Preamble contemplates that "participating FFIs" and "registered deemed-compliant FFIs" will register with the IRS through the FATCA Portal, enter into an FFI Agreement (in the case of "participating FFIs") and receive their "Global Intermediary Identification Number" (GIIN) beginning no later than October 15, 2013.[\[4\]](#)

In connection with a variety of compliance purposes under FATCA, withholding agents will be required to confirm an FFI's status against a list of "participating FFIs" and "registered deemed-compliant FFIs" (IRS FFI List). The Preamble announces that the IRS will post electronically the first IRS FFI List on December 2, 2013 and intends to update the IRS FFI List on a monthly basis thereafter. The last date by which an FFI can register with the IRS to ensure its inclusion on the December 2013 IRS FFI List, the last IRS FFI List published before FATCA withholding on certain Withholdable Payments commences, is October 25, 2013 (as discussed above under "Certain Key FATCA Dates").

#### *Terms of the FFI Agreement*

The Final Regulations provide significant detail regarding the obligations and conditions that will apply to a "participating FFI" under the FFI Agreement. In addition to setting forth the reporting, withholding and other obligations that an FFI will be required to undertake under the FFI Agreement, the Final Regulations also describe:

- The FATCA compliance program that an FFI will be required to implement. The compliance program must be overseen by a compliance officer that will be required to make periodic certifications to the IRS regarding the FFI's compliance with FATCA.
- Compliance failures that will constitute an event of default with respect to the FFI Agreement and the circumstances in which an FFI will be permitted to remedy an event of default.
- The actions an FFI must undertake if non-U.S. law prevents the FFI from reporting the required information to the IRS with respect to a U.S. account or prevents the FFI from withholding the 30% FATCA tax from a "recalcitrant account holder" or "nonparticipating FFI."
- A new procedure whereby an FFI may, in certain circumstances, request a credit or refund with respect to an account holder if there has been an overpayment of tax under FATCA.

The Treasury Department and the IRS expect to publish a revenue procedure setting out the terms of the FFI Agreement that are consistent with the Final Regulations, and which also will include information for FFIs that also have withholding responsibilities as a "qualified intermediary" (QI), as a "withholding foreign partnership" (WP) or as a "withholding foreign trust" (WT) under the general source withholding rules.[\[5\]](#) As noted above, an FFI that chooses to become a "participating FFI" will enter into the FFI Agreement through the FATCA Portal. The Final Regulations provide that the effective date of an FFI Agreement for an FFI that receives a GIIN prior to January 1, 2014 will be December 31, 2013.

#### *Modified Definition of "Financial Institution"*

The Final Regulations modify the definition of "financial institution" to more closely conform to the definition of "financial institution" used in the model IGAs by adding the defined term "investment entity." [\[6\]](#) As a result of this change, it is more certain that entities that are fund managers generally will be treated as "financial institutions" under FATCA. In addition, non-U.S. entities that are passive entities that are not professionally managed generally will not be treated as "financial institutions" for purposes of FATCA, but rather as "passive NFFEs."

#### *FFI Exceptions for Holding Companies, Treasury Centers and Captive Financial Companies*

The Final Regulations provide highly limited exceptions from the definition of FFI for holding companies within an affiliated group, companies which provide treasury services (Treasury Centers) and captive finance companies; however, the Preamble notes that these exceptions are intended to be inapplicable where the expanded affiliated group which includes such an entity is a financial group, and also are not intended to be available where the entity is formed by a private equity group or similar arrangement.

#### *Special Exceptions to the Scope of the FFI Definition*

The Final Regulations provide an exception for an "active NFFE" that changes its line of business under certain circumstances.



Although a general exception from FFI status generally is afforded to exempt organizations described in Code Section 501(c), the Final Regulations eliminate the exception from the definition of an FFI for small insurance companies described in Section 501(c)(15).

#### *Expansion of "Deemed-Compliant FFIs"*

The Final Regulations expand the categories of FFIs that will be considered "deemed-compliant" (generally, an FFI that is not required to enter into an FFI Agreement to avoid withholding under FATCA, although if the FFI is considered a "registered deemed-compliant FFI" it still will be required to register with the IRS for purposes of FATCA and obtain a GIIN) in certain important respects:

- *Sponsored Investment Entities.* A new category of "deemed-compliant FFI" has been added that will give certain fund managers the option to consolidate FATCA compliance for all FFIs that it manages. In particular, a fund manager that is authorized to manage an FFI (other than an FFI that is a QI, WP or WT) and enter into contracts on behalf of the FFI, and satisfies certain other requirements, may agree to treat that FFI as a "sponsored FFI" and perform on behalf of the sponsored FFI, all due diligence, withholding, reporting and other requirements that the "sponsored FFI" would have been required to perform if it were itself a "participating FFI." The "sponsored FFI" would be registered with the IRS as a "registered deemed-compliant FFI" (and also would appear on the published IRS FFI List).
- *Qualified Collective Investment Vehicles.* Consistent with prior guidance, the Final Regulations treat certain "qualified collective investment vehicles" as "deemed-compliant FFIs." As a general matter, a "qualified collective investment vehicle" is an "investment entity" that is regulated as an investment fund either in its country of organization or in all of the countries in which it is registered and operates (or the fund manager is regulated with respect to the investment fund in all of the countries in which the investment fund is registered and operates), that only has as investors "participating FFIs" and certain other types of investors and satisfies certain other requirements. The primary purpose of this category, as stated in the Preamble, is to provide relief for investment entities that are owned solely through "participating FFIs" or directly by large institutional investors, payments to which otherwise would not be subject to withholding or reporting under FATCA. The Final Regulations expand the universe of investors that may own an interest in a "qualified collective investment vehicle" to include certain retirement plans and nonprofit organizations.

In addition to these rules, the Final Regulations and Preamble provide important guidance relating to the "deemed-compliant" or "certified deemed-compliant" status of a variety of entities with specialized structures or operations, including:

- "Restricted funds" (foreign funds which target only foreign investors).
- Credit card issuers that accept associated deposits.
- Certain very small local banks.
- Certain sponsored closely-held investment vehicles.
- Certain limited-life debt investment entities (the Final Regulations provide transition relief to certain CLOs in existence as of December 31, 2011 by treating them as "certified deemed-compliant FFIs" prior to January 1, 2017).

The Final Regulations and Preamble also discuss certain rules applicable to the debt limitation on "owner-documented FFIs" and the use of "restricted distributors" by participating FFIs to distribute interests in "restricted funds."

#### *Expansion of Foreign Retirement Funds Treated as "Exempt Beneficial Owners"*

A "financial institution" that is an "exempt beneficial owner" is not required to enter into an FFI Agreement with the IRS and is not subject to withholding under FATCA. "Exempt beneficial owners" include foreign governments, international organizations, foreign central banks and certain foreign retirement funds.

Among certain other changes (including, that an otherwise qualified retirement fund may be treated as an "exempt beneficial owner" without regard to whether the retirement fund is treated as the beneficial owner of income), the Final Regulations:

- Modify the category of treaty-qualified retirement funds to provide that a retirement fund may qualify as an "exempt beneficial owner" under this category regardless of whether the retirement fund is generally exempt from taxation in the country in which it is organized.

- Provide that in certain circumstances a retirement fund that provides disability or death benefits may be treated as an "exempt beneficial owner."
- Relax the requirement that a retirement fund only receive contributions from the employer or employee.
- Add as new categories of "exempt beneficial owner:" (i) a plan-sponsored fund that would meet the requirements of Code Section 401(a), other than the requirement that the plan be funded by a trust created or organized in the U.S. and (ii) a fund established exclusively to earn income for the benefit of one or more retirement funds that are "exempt beneficial owners" under FATCA.
- Clarify that certain retirement funds established and sponsored by an "exempt beneficial owner" (such as a foreign government) also will be treated as "exempt beneficial owners" under FATCA.

#### *Changes to the Definitions of Withholdable Payments and Scope of Grandfathered Obligations*

The Final Regulations adopt important clarifications to the definition of a "grandfathered obligation," payments with respect to which are not subject to FATCA withholding tax. As previously announced by the Treasury Department and the IRS, the Final Regulations provide that a "grandfathered obligation" includes an "obligation" (i.e., a legally binding agreement or instrument that is not treated as equity for U.S. tax purposes and satisfies certain other conditions) that is outstanding on January 1, 2014 (under the Proposed Regulations the date was January 1, 2013). A "grandfathered obligation" includes a revolving credit facility, provided that the agreement as of its issue date fixes the material terms under which the credit will be provided.

"Grandfathered obligations" also include: (i) any obligation that can produce a "foreign passthru payment" but not a Withholdable Payment that is outstanding on the date that is six months after final regulations defining "foreign passthru payments" are published; (ii) any obligation that can give rise to Withholdable Payments solely because the obligation gives rise to a "dividend equivalent amount" under Section 871(m) (e.g., certain equity swaps) that is outstanding on the date that is six months after final regulations are published treating that type of instrument as giving rise to a "dividend equivalent amount;" and (iii) any obligation to make a payment with respect to or to repay collateral posted to secure an obligation that is itself a "grandfathered obligation."

The Final Regulations adopt certain important changes to the definition of "gross proceeds" (withholding with respect to which will not be required until January 1, 2017), including a rule allowing clearing organizations to determine "gross proceeds" based on net amounts paid or credited to a member's account in accordance with the clearing organization's rules, and a rule that any contract that can result in the payment of a dividend equivalent under Section 871(m) is treated as property that can produce U.S.-source FDAP income, including where the dividend equivalent is part of a termination payment on the contract. The Final Regulations also exclude from the definition of "gross proceeds" the proceeds of securities repurchase transactions described in Section 1058.

The Final Regulations provide exceptions to the general scope of Withholdable Payments, including:

- A temporary exclusion for U.S.-source FDAP income made with regard to an "offshore obligation" prior to January 1, 2017 unless made by a person acting as an intermediary (including, a qualified securities lender), subject to limitations applicable to flow-through entities.
- A comprehensive exception for excluded nonfinancial payments.
- A change clarifying that certain gains from the sale of property are not a payment of U.S.-source FDAP income, conforming to the general source withholding rules.

#### *Other Provisions of the Final Regulations*

The Final Regulations also set forth detailed rules regarding the following areas (including a number of related compliance issues):

- The due diligence requirements imposed under FATCA (in particular, making numerous specific changes to the documentation that must be collected from account holders under FATCA).
- Identifying the person to whom a payment is made under FATCA.
- Payment of any tax withheld under FATCA.
- Circumstances under which a credit or a refund of any tax withheld under FATCA is available.

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As noted above, the Final Regulations are voluminous, and the changes and amendments contained therein from the Proposed Regulations are very substantial. The provisions summarized above represent certain key provisions of the Final Regulations, but neither represent a comprehensive summary of all of the changes and amendments included, nor a discussion of the application of the Final Regulations in a host of special circumstances. Institutions and persons affected by the compliance obligations of the Final Regulations, as well as those entering into transactions potentially subject to FATCA withholding based on either their own FATCA compliance or the FATCA compliance of their counterparties, should be taking affirmative steps with respect to FATCA implementation to the extent they have not already begun doing so.

If you would like to discuss the Final Regulations or FATCA-related matters generally at any time, please contact any of the lawyers listed on this alert or the member of the Proskauer Tax Group with whom you normally consult on these matters.

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[1] FATCA refers to Sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended (Code). The final Treasury Regulations described in this client alert were promulgated pursuant to such Sections of the Code and will be effective on the date the Treasury Regulations are published in the Federal Register, which is expected to be January 28, 2013.

[2] Please see our previous client alerts "[IRS Announces Extended FATCA Deadlines](#)" (October 25, 2012), "[United Kingdom and United States Conclude FATCA Intergovernmental Agreement](#)" (September 25, 2012), "[ISDA Publishes 2012 FATCA Protocol](#)" (August 28, 2012), "[IRS Posts Draft Revised Withholding Forms Conforming to FATCA](#)" (June 8, 2012), "[IRS and Treasury Department Publish Anticipated FATCA Guidance](#)" (February 9, 2012) and "[IRS Issues Preliminary Guidance on the Application of the Foreign Account Tax Compliance Act](#)" (September 24, 2010).

[3] FFIs covered by Model 1 IGAs will be required to register with the IRS as a "registered deemed-compliant FFI" and obtain a "Global Intermediary Identification Number" (as discussed under "FATCA Registration – Timeline and Process").

[4] The Final Regulations generally provide that a GIIN will be used as the FFI's identifying number for satisfying its reporting requirements under FATCA and identifying its status to withholding agents.

[5] The general source withholding rules are set forth in Code Sections 1441-1464 and the regulations thereunder.

[6] Among other types of entities, an "investment entity" includes an entity that primarily conducts as a business on behalf of a customer: (i) trading in certain financial instruments, including money market instruments (including derivatives), foreign currency, foreign exchange, interest rate and index instruments, transferable securities or commodity futures; (ii) individual or collective portfolio management; or (iii) otherwise investing, administering, or managing funds, money or financial assets on behalf of other persons. Under the Final Regulations, entities that function or "hold themselves out" as mutual funds, hedge funds or any similar investment vehicle established with an investing, reinvesting or trading strategy in financial assets are also "investment entities," although neither the Final Regulations nor the Preamble discusses what it means for an entity to "hold itself out" as such an investment vehicle.

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