Client Alert

Chapman and Cutler LLP
Attorneys at Law · Focused on Finance®

CURRENT ISSUES RELEVANT TO OUR CLIENTS February 22, 2013

FATCA Final Regulations Released

On January 17, 2013, the IRS released the long-awaited final regulations under Code §§ 1471-1474, generally referred to as the Foreign Account Tax Compliance Act (FATCA) provisions. The final regulations adopt and amend the proposed regulations (REG-121647-10), which were released in February 2012. This Client Alert briefly summarizes the most significant updates from the proposed regulations to the finalized regulations.

Background: The FATCA requirements

The FATCA regime was enacted in the United States in 2010 as a way to encourage tax reporting and compliance regarding assets owned by US persons through foreign accounts. Under FATCA, a new 30 percent withholding is required on withholdable payments to non-US entities unless they comply with the information-gathering and reporting requirements of FATCA. The withholding "tax" is generally called FATCA withholding and is separate from regular withholding under Code § 1441. FATCA withholding generally applies to distributions after December 31, 2013.

FATCA withholding has two major parts: withholdable payments to foreign financial institutions (FFIs) and payments to non-financial foreign entities (NFFEs).

- Payments to FFIs will be subject to FATCA withholding unless the FFI enters into an agreement with the IRS to determine whether the entity has any direct or indirect US account holders. The agreement will also obligate FFIs to withhold on passthru payments made by the FFI.

- Payments to NFFEs will be subject to FATCA withholding unless the NFFE certifies that it has no direct or indirect US owners of more than 10 percent of the NFEE's equity (or provides information about those that it has).

Significant Changes to the FATCA Regulations

- Grandfathered obligations
- Deemed-compliant and exempt FFIs
- Substitute forms and the "eyeball" test
- FATCA Registration Web Portal

Grandfathered Obligations

The proposed regulations exempted "grandfathered obligations" from the withholding and information-reporting rules of FATCA. Generally, grandfathered obligations were defined as obligations that would be outstanding on a certain date. The final regulations push back the grandfather date so that FATCA does not apply to obligations outstanding on January 1, 2014.

In addition to obligations outstanding on January 1, 2014, the final regulations add two other items to the definition of "grandfathered obligation":

1. Obligations that produce withholdable payments solely because the obligation is treated as giving rise to a dividend equivalent under Code § 871(m) and are executed on or before the date that is six months after the date on which the obligations of its type are first treated as giving rise to dividend equivalents.

Attorney Advertising Material

2. Any agreement requiring a secured party to make payments with respect to collateral securing one or more grandfathered obligations

An "obligation," for these purposes, includes a debt instrument (such as a bond), a credit agreement and a life insurance contract. It does not include a legal agreement or instrument that is treated as equity for US tax purposes. Otherwise, grandfathered obligations may lose their "grandfathered" status if they are modified after December 31, 2013.

In addition, the final regulations delay FATCA withholding on gross proceeds until after December 31, 2016.

Deemed-compliant and Exempt FFIs

The proposed regulations created two categories of deemed-compliant FFIs: (1) registered deemed compliant FFIs and (2) certified deemed compliant FFIs. Registered deemed compliant FFIs include local FFIs, nonreporting members of participating FFI groups, qualified investment vehicles, restricted funds and FFIs that comply with an Intergovernmental Agreement (IGA). Certified deemed-compliant FFIs include nonregistering local banks, nonprofit organizations, certain owner-documented FFIs and FFIs with only low-value accounts.

The final regulations include the following additions and modifications:

- The category of deemed-compliant FFIs is expanded to include "sponsored investment entities," for which a sponsoring entity agrees to perform all due diligence, withholding, reporting and other requirements which the FFI would have been required to perform under FATCA.
- The deemed-compliant status for "qualified collective investment vehicles" (Qualified CIV) is retained but clarified so that retirement plans and nonprofit organizations may become account holders of the fund without causing the fund to fail Qualified CIV status.
- Funds that have investors that do not fit into the permitted categories for a Qualified CIV may still be able to qualify as deemed-compliant as "restricted funds," a category that was also available under the proposed regulations. The final regulations clarified that interests in restricted funds may be issued by the fund directly as long as the investor can only dispose of those interests by having them redeemed or transferred by the fund, and not by selling them on a secondary market.
- The scope of retirement funds that qualify as exempt beneficial owners is expanded. (Payments to exempt beneficial owners are exempt from FATCA.)

Substitute Forms and the "Eyeball" Test

For purposes of determining whether a payment is subject to FATCA withholding, a withholding agent may review a Form W-8 provided by the recipient and provide it to the IRS. In response to comments to the proposed regulations, a substitute form (in place of an official Form W-8) will be accepted, provided the substitute form contains the same certifications and required information as the official IRS form. If the form is in a foreign language, the withholding agent must furnish the IRS with a translated version upon request. Also, the form must also include a signature-under-penalties-of-perjury statement identical to the one on the official form. A form that does not contain every provision from the official form will still be accepted as long as it contains the provisions relevant to the transaction for which it is furnished.

Comments also requested the incorporation of the so-called "eyeball" test from other chapters of the Code. In response, the final regulations permit a withholding agent to rely on documentary evidence instead of a Form W-9 to determine an entity's status as a US person and to use the eyeball test to determine the payee's status as other than a specified US person. Generally, the eyeball test allows a withholding agent to rely upon a person's entity classification contained in a valid Form W-8 or W-9 if the withholding agent has no reason to know that the entity classification is incorrect.

FATCA Registration Web Portal

The final regulations introduce the benefit that FFIs will be able to register with the IRS through a secure online web portal, which is planned to achieve a completely paperless registration process. FFIs will be able to use the portal to register their status (such as "participating FFI"), to manage their registration information and to make agreements required for their status. Leaders of affiliated groups will be able to use the portal to manage the status of their group members. The final regulations envision the portal as the primary means for financial institutions to interact with the IRS to complete and maintain their

FATCA agreements, registrations and certifications. The portal is expected to be accessible to financial institutions no later than July 15, 2013.

Conclusion

The final regulations have provided many clarifications and additional rules regarding compliance with FATCA. However, there will still be many burdens with compliance. Furthermore, some countries have already signed IGAs and many additional countries plan to sign them, overriding the substantive information-reporting requirements under FATCA, although the definitions under the final regulations may still be applicable.

Key Terms

FATCA
Foreign Account Tax Compliance Act, enacted as Code §§ 1471 through 1474, and included as part of the larger HIRE Act.

FFI
Foreign financial institution. A financial institution is any entity which (1) accepts deposits in the ordinary course of a banking or similar business, (2) as a substantial portion of its business, holds financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests or commodities. Thus, a financial institution would include a hedge fund, a private equity fund or other collective investment vehicle, as well as a bank.

An insurance company will not be a financial institution for these purposes if the insurance company only sells property or casualty insurance or reinsurance contracts.

HIRE Act
Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147 (H.R.2847).

Intergovernmental Agreement (IGA)
Agreement between the IRS and a taxing authority of another nation which allows automatic information exchanges of account holder information between governments. Generally, FFIs which are resident in a country with an effective IGA will report to their own government and not to the IRS.

Passthru Payment
The regulations reserve in part on the definition for passthru payments, but they are generally understood to refer to withholdable payments or other payments made by an intermediary or by a foreign passthru entity to the extent attributable to a withholdable payment.

Withholdable Payment
A withholdable payment includes (1) any FDAP payment if such payment is from sources within the United States and (2) any gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the United States.

To discuss any of the topics covered in this Client Alert, please contact Paul Carman at (312) 845-3443, or visit us online at Chapman.com.

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

© Chapman and Cutler LLP, 2013. All Rights Reserved.