FATCA Update

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IRS and Treasury issue proposed and temporary regulations under FATCA, as well as 'conforming regulations' under chapters 3 and 61

On 20 February 2014, the IRS and Treasury released proposed and temporary regulations (TD 9657 and TD 9658) providing further guidance under the Foreign Account Tax Compliance Act (FATCA) and "conforming" the requirements in chapters 3 and 61 of the Internal Revenue Code (i.e., the Section 1441 rules applicable to withholding and reporting on payments made to nonresident aliens and the Form 1099 reporting and backup withholding requirements imposed on payments to US persons) with the requirements of FATCA, which is also known as "chapter 4."

Implication: The release of these regulations is significant for virtually all US withholding agents, including financial institutions, insurance companies and asset management companies, as well as non-financial, multinational companies. While many of these entities do not have foreign financial institutions with extensive offshore operations within their groups, they all make payments to foreign persons (and presumed foreign persons) that will be affected by these new rules.

The regulations do not further delay the effective date of FATCA, which remains July 1, 2014. Furthermore, the effective date of the conforming regulations is also generally July 1, 2014. Therefore, US withholding agents do not have much time to get ready for the new onboarding processes and procedures they must implement before then.

Implication: Unfortunately, the IRS has still not issued final, revised Forms W-8 (or their instructions) reflecting the changes required by FATCA and the conforming regulations. These forms are critical to every withholding agent's implementation of these rules.

The "conforming regulations"

While FATCA withholding may apply to payments made by a US withholding agent to a foreign entity, it does not apply to payments made by a US withholding agent to a nonresident alien individual. Backup withholding does apply, however, to payments made by a US withholding agent to an individual who is not properly documented for chapter 3 or chapter 4 purposes and the "conforming regulations" modify those regulations to impose many of the provisions in the FATCA regulations on the payments made by US withholding agents to both foreign and US individuals and entities. For example:

- US withholding agents will be able to rely on a fax or pdf of a valid withholding certificate, so long as they do not know that the person who transmitted the document did not have the authority from the person who executed the form to do so.

  Implication: This is a very welcome change to the rules, but keep in mind that it becomes effective July 1, 2014.

- Just like for FATCA purposes, for purposes of Section 1441, in the absence of a withholding certificate or documentary evidence, a withholding agent must treat an entity that would be an exempt recipient under the so-called "eyeball test" of Treas. Reg. Section 1.6049-4(c)(1)(ii) as a foreign payee. However, the eyeball test will continue to apply to a withholdable payment made with respect to a pre-existing obligation to a payee who the withholding agent classified as a US exempt recipient prior to July 1, 2014.

  Implication: Many withholding agents will be surprised by this provision, which essentially requires a US withholding agent to have on file a Form W-9, *Request for TIN and Certification*, or documentary evidence from all exempt recipients to whom it makes US-source FDAP payments under obligations entered after June 30, 2014. So, if a US manufacturing company borrows money from the US bank across the street after June 30, 2014, it must have a valid Form W-9 on file from the bank. While many Accounts Payable departments require Forms W-9 from all new US vendors, they typically do not require them from payees with whom they did business before the policy began, or from those who are paid through the Treasury function.

- For accounts opened after June 30, 2014, if a US withholding agent knows that a person was born in the US, but is claiming foreign status, the withholding agent must get proof that she has renounced her US citizenship. However, US withholding agents are not required to search any documentation on file to determine whether they have a person's place of birth (or other US indicia) in their records for an account opened prior to 1 July 2014, unless they otherwise review the documentation on file or there is a "change of circumstances" with respect to the account. Apparently, the new Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner,* will require both country and date of birth, in addition to a person's foreign taxpayer identification number (TIN), if any.
- Valid Forms W-8 furnished after June 30, 2014, may be treated as "evergreen" in certain situations when there are no US indicia, so long as documentary evidence supporting the claim of foreign status was furnished with the Form W-8 and there has not been a change in circumstances making the information on the documentation incorrect. To be valid, however, a Form W-8 must be completed in full. For example, it cannot be invalid for chapter 4 purposes, and be treated as valid for chapter 3 purposes. Also, the current law provision allowing a withholding agent to treat a Form W-8 valid indefinitely so long as it has a US TIN and the withholding agent reports a payment to the foreign person each year on a Form 1042-S, *Foreign Person's US Source Income Subject to Withholding,* no longer applies.
- If the only phone number a withholding agent has on file for a nonresident alien is a US phone number, it must "cure" those US indicia.

- When a written explanation is required to cure US indicia, the foreign person may furnish either a written statement or complete a checklist furnished by the withholding agent.

  Implication: The IRS has historically rejected the use of a checklist for purposes of providing a written explanation for US indicia for chapter 3 purposes. Since English is, at best, a second language for many nonresident aliens, the ability to provide a checklist to account holders will be welcomed by most US withholding agents.

- A limited number of "inconsequential errors" will not invalidate a withholding certificate.
- When a withholding certificate is received more than 30 days after a payment is made, an affidavit stating that the information and representations contained on the certificate were accurate as of the time of the payment will be required. For a withholding certificate received more than a year after the date of payment, documentary evidence will also be required.
- A valid withholding certificate from a qualified intermediary (QI) or nonqualified intermediary (NQI) certifying its chapter 4 status must provide its Global Intermediary Identification Number (GIIN), if applicable.
- A withholding agent must collect revised versions of Forms W-8 six months after their issuance by the IRS. However, this rule specifically does not apply to Forms W-9.
- A withholding agent may rely on valid documentation collected by a predecessor or transferor with respect to accounts acquired in mergers and bulk acquisitions for value. Also, if the acquisition is from an unrelated US withholding agent, the withholding agent may generally rely on the predecessor's determination of an account holder's chapter 3 status for a transition period of six months.

  Implication: Therefore, a withholding agent will have six months post acquisition to perform due diligence on the validity of the withholding certificates it has acquired.

  Other important items to note in the conforming regulations include:

- A change to the requirement that a nonresident alien furnish a US TIN to claim a reduced rate of withholding under a US treaty on income other than payments with respect to publicly traded securities. After June 30, 2014, either a US TIN or a foreign TIN will be required.

  Implication: This is a significant and unexpected change to a provision that has challenged many withholding agents and nonresident aliens, especially with respect to payments of interest (that do not otherwise qualify for either the bank deposit exception or portfolio interest treatment), fees associated with loan syndications and payments for royalties, licensing fees and services rendered.

- A requirement that, for payments made after December 31, 2014, a withholding agent must issue separate Forms 1042-S for each type of income or payment made to a foreign person.
- Self-certifications that may be collected for chapter 4 purposes by foreign financial institutions (FFIs) will not satisfy a withholding agent's chapter 3 documentation requirements.
- Modification of the definition of a "sale effected outside the US" to require that no office of the same broker in the US either negotiated the sale or received instructions regarding the sale.
- The apparent end to "QI audit reports" that must be sent to the IRS.
- The preamble to the regulations specifically provides that, while a withholding agent may rely upon documentation collected by a third-party data provider in order to establish the chapter 4 status of an entity, for purposes of chapter 3, withholding agents (or their agent) must obtain documentation directly from the payee.
- A substitute Form W-8 can delete provisions not applicable to the purpose for which the form is solicited. For example, a substitute form is not required to solicit a treaty claim if

payments made to the payee by the withholding agent soliciting the form will be limited to bank deposit interest. Likewise, an Accounts Payable Department can delete chapter 4 status from a substitute Form W-8 collected for purposes of nonfinancial payments. Substitute forms may also be collected in foreign languages, so long as a translation is provided to the IRS upon request.

Modifications to the FATCA regulations

The temporary and proposed regulations issued under FATCA make a series of modifications to the final FATCA regulations released in January 2013. Some of these modifications were originally announced in Notice 2013-69, particularly with respect to the effective dates of FATCA (e.g., moving the effective date for FATCA withholding on new accounts to July 1, 2014, classifying accounts opened before July 1, 2014, as "pre-existing accounts" and defining "grandfathered obligations" for FATCA purposes as obligations issued before July 1, 2014) and in the final FFI agreement released in Revenue Procedure 2014-13.

In addition:

- A withholding agent (other than the issuer or an agent of the issuer) will only be required to treat a modification of a grandfathered obligation as material if the withholding agent has actual knowledge that a material modification has occurred.
- The US intermediary or agent payee provision was modified to provide that a US insurance broker who is acting as an intermediary for, or agent of, a foreign person, will be treated as the payee (rather than treating the foreign person as the payee). Note: A non-US insurance broker is still treated as an intermediary, except for US-source FDAP payments made before January 1, 2017, with respect to an offshore obligation (discussed later).
- The exclusion from the definition of withholdable payment was expanded for purposes of the transition rule afforded to offshore obligations. Solely for purposes of the transition rule, a non-US insurance broker is not an intermediary with respect to premiums paid. This means US-source insurance and reinsurance premiums paid before January 1, 2017, by a non-US insurance broker on offshore obligations (insurance policies) are not withholdable payments. Note, for all other purposes, a non-US insurance broker (unlike a US insurance broker) will be treated as an intermediary with respect to withholdable payments.
- Withholding agents (other than participating FFIs or registered deemed-compliant FFIs) may treat the payee of a payment with respect to a pre-existing obligation as a US person if the withholding agent previously classified the payee as a US exempt recipient for purposes of chapters 3 and 61, even if it did so using the "eyeball test." If a pre-existing account holder's Form W-8 expires and the account becomes undocumented, however, the "new" presumption rules would apply.
- The term "branch" with respect to an FFI includes an entity that is disregarded as an entity separate from the FFI.
- The definition of an expanded affiliated group (EAG) has been modified and is easier to apply. Specifically, FFIs are no longer required to apply the indirect ownership and constructive ownership provisions. A non-corporate entity (e.g., partnership or trust) can elect to be a common parent entity, thus removing the requirement for the common parent to be a corporation.
- The regulations clarify that a sponsoring entity will not be jointly and severally liable for a sponsored FFI's obligations unless the sponsoring entity is also a withholding agent that is separately liable for those obligations.
- The regulations provide a definition of the term "formed or availed of" for purposes of an entity not being classified as an FFI because it meets the excepted nonfinancial group entity exclusion. For purposes of the exclusion, an entity (e.g., holding company) will be treated as being formed or availed of (and qualify for the exclusion) if the entity existed and regularly conducted activities in the ordinary course of business at least six months prior to an acquisition, provided the facts do not suggest the contrary.

- For purposes of the excepted nonfinancial group entity exclusion, the holding company definition was expanded to include a partnership or any other non-corporate entity if substantially all the entity's activities consist of holding more than 50% of the voting power and value of the stock of one or more common parent corporations of one or more EAGs.
- The excepted inter-affiliate FFI exclusion was modified to allow an FFI to hold a depository account at an entity outside of its EAG, if the account is in the same country in which the FFI is operating and it is used for purposes of paying operating expenses in that same country.
- Multiple "clarifications" are made regarding duplicative reporting between chapters 3, 4 and 61. While duplicative reporting is eliminated in some circumstances, it remains in many.

Finally…

The validity period of Forms W-8, which would have expired on December 31, 2013, has been extended once again. Those forms' validity period was previously extended by the IRS to June 30, 2014, and has now been extended again to December 31, 2014.

In addition to the final forms and instructions, the IRS intends to issue additional regulations under FATCA describing the verification requirements of sponsoring entities and a revenue procedure revising the FFI agreement to conform to these proposed and temporary regulations.
A more detailed Alert explaining the proposed and temporary regulations further will be released shortly.