

Client Alert.

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IRS Issues Initial Guidance on FATCA Withholding and Reporting

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On August 27, 2010, the Internal Revenue Service (“IRS”) and Treasury Department (“Treasury”) issued Notice 2010-60 (“Notice”) setting forth initial guidance with respect to the new reporting and withholding obligations enacted into law on March 18, 2010 as part of the Foreign Account Tax Compliance Act (“FATCA”).¹ FATCA introduced a new 30% withholding tax on any “withholdable payment” made to either a foreign financial institution (“FFI”) or a non-financial foreign entity (“NFFE”) unless the FFI meets certain reporting obligations or the NFFE discloses certain information regarding substantial U.S. owners. A “withholdable payment” generally includes any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income from sources within the U.S. It also includes gross proceeds from the sale of property that is of a type that can produce U.S.-source dividends or interest, such as stock or debt issued by domestic corporations. The new 30% withholding tax on any “withholdable payment” made to an FFI (whether or not beneficially owned by such institution) applies unless the FFI agrees, pursuant to an agreement entered into with Treasury (“FFI Agreement”), to provide information with respect to each “financial account” held by “specified U.S. persons” and “U.S.-owned foreign entities.”

The new reporting and withholding provisions apply to payments made after December 31, 2012 and obligations outstanding on March 18, 2012 are grandfathered.

The Notice includes guidance regarding (1) the grandfather provision, (2) the definition of an FFI, (3) the scope of required information collection and identification of persons by FFIs, and (4) the manner and type of information that FFIs must provide to the IRS with respect to U.S. accounts. The Notice further indicates that the IRS and Treasury intend to issue regulations incorporating the guidance provided in the Notice and addressing other relevant matters. In addition, the IRS and Treasury request comments on the issues addressed in the Notice. Although the Notice sets forth some of the requirements that participating FFIs will need to comply with pursuant to an FFI Agreement, a draft agreement is not yet available. The Notice does not provide guidance on the obligations imposed on NFFEs by FATCA.

1. GRANDFATHER PROVISION

The Notice provides that the term “obligation” for purposes of the grandfather provision means any legal agreement that produces or could produce withholdable payments. However, an obligation does not include any instrument treated as equity for U.S. tax purposes or any legal agreement that lacks a definitive expiration or term (e.g., savings deposits, demand deposits, or other similar accounts, and brokerage, custodial, and similar agreements to hold financial assets for the account of others and to make and receive payments of income and other amounts with respect to such assets). Thus, these excluded instruments and agreements are not eligible for grandfathering.

¹ FATCA was included in the Hiring Incentives to Restore Employment Act of 2010. See our prior client alert discussing the FATCA provisions at <http://www.mofo.com/files/Uploads/Images/100322FATCA.pdf>.

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For purposes of the grandfather provision, any material modification of an obligation will result in the obligation being treated as newly issued on the date of the material modification. Whether a modification is considered material will be based on all the relevant facts and circumstances. In the case of an obligation that is a debt instrument for U.S. tax purposes, a material modification means a significant modification as defined in Treasury regulations.²

2. DEFINITION OF AN FFI

Entities Treated as FFIs or Excluded as FFIs

The Notice includes guidance with respect to the three categories of entities that are considered FFIs:

- (a) Entities that accept deposits in the ordinary course of a banking or similar business, including, but not limited to, entities that would qualify as banks under Section 585(a)(2) (including banks as defined in Section 581 and any corporation to which Section 581 would apply except for the fact that it is a foreign corporation), savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies and other cooperative banking institutions.
- (b) Entities that, as a substantial portion of their business, hold financial assets for the account of others (e.g., broker-dealers, clearing organizations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans).
- (c) Entities engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities (including through derivatives), such as mutual funds (or their foreign equivalent), funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles.³

The Notice further addresses certain entities that are excluded from the definition of an FFI or are otherwise exempt from some or all of the reporting or withholding obligations:

- (a) Certain holding companies, start-up companies, non-financial entities that are liquidating or emerging from reorganization or bankruptcy, and hedging and financing centers of a non-financial group are excluded from being FFIs, but will be NFFEs. Payments beneficially owned by these entities, however, will be exempt from the NFFE withholding tax.
- (b) Insurance companies whose business consists solely of issuing insurance contracts without cash value (e.g., property and casualty insurance, reinsurance contracts, or term life insurance contracts) are excluded from the definition of an FFI, but will be NFFEs.
- (c) Investment funds with a small number of direct or indirect account holders will be treated as deemed-compliant FFIs⁴ if certain documentation requirements are met by persons with an interest in such funds.

² Section 1.1001-3. All Section references are to the Internal Revenue Code of 1986, as amended ("Code"), and the Treasury regulations promulgated thereunder.

³ The Notice indicates that the concept of "business" used in Section 1471(d)(5)(C) is different in scope and content from the scope of a "trade or business" used in other sections of the Code and that future regulations will provide guidelines for determining what types of activities constitute a "business" for these purposes.

⁴ A deemed-compliant FFI is an FFI that: (i) complies with such procedures as the Treasury may prescribe to ensure that the FFI does not maintain U.S. accounts and meets such other requirements as the Treasury may prescribe with respect to accounts of other FFIs maintained by such FFI, or (ii) is a

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- (d) Certain foreign retirement plans are considered to pose a low risk of tax evasion and payments beneficially owned by such retirement plans will be exempt from withholding even though a foreign retirement plan may qualify as an FFI.

Controlled Foreign Corporations

The Notice indicates that, although comments were received requesting that a controlled foreign corporation (“CFC”) that qualifies as an FFI will be treated as a deemed-compliant FFI because CFCs are already subject to various information reporting requirements, CFCs will not be exempted from the requirements imposed on FFIs. However, Treasury and the IRS anticipate coordinating the FFI reporting requirements with existing reporting requirements by CFC to avoid duplicative reporting.

3. IDENTIFICATION AND INFORMATION COLLECTION

In order to avoid the new withholding tax, an FFI must enter into an FFI Agreement with Treasury (thereby becoming a “participating FFI”). Pursuant to the FFI Agreement, the FFI must agree to, among others, (i) determine which of its accounts are U.S. accounts, (ii) comply with Treasury due diligence procedures with respect to the identification of U.S. accounts, (iii) report certain information with respect to U.S. accounts, and (iv) withhold tax on certain payments to non-participating FFIs and recalcitrant account holders.⁵ Although a draft FFI Agreement is not yet available, the Notice sets forth some of the requirements that participating FFIs will need to comply with pursuant to such an agreement.

Identification by FFIs

A participating FFI will first need to determine:

- (a) whether individual account holders are to be treated as U.S. persons or other persons; and
- (b) whether account holders that are entities are to be treated as U.S. persons, FFIs, entities described in Section 1471(f) (e.g., foreign governments and international organizations), or NFFEs.

Thereafter, a participating FFI must determine:

- (a) whether entities that are U.S. persons are to be treated as specified U.S. persons or other U.S. persons;
- (b) whether FFIs are to be treated as participating FFIs, deemed-compliant FFIs, or non-participating FFIs; and
- (c) whether NFFEs are to be treated as U.S.-owned foreign entities. For this purpose, an NFFE is treated as a U.S.-owned foreign entity to the extent it is determined to have substantial U.S. owners. Any entity that is an excepted NFFE will be excluded from the definition of a U.S.-owned foreign entity.

member of a class of institutions with respect to which the Treasury determines that application of the new withholding tax is not necessary to carry out the purposes of the FATCA provisions. Because such a deemed-compliant FFI would remain a “financial institution,” it would not be an NFFE, and therefore would not be subject to the withholding tax applicable to NFFEs.

⁵ Recalcitrant account holders are those account holders that fail to comply with reasonable requests for information by a participating FFI in order for it to meet its obligations under the relevant provisions, or that fail to provide a waiver in any case in which any foreign law would (but for such waiver) prevent the reporting of any information an FFI is required to report.

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Identification by U.S. Branches and USFIs

The Notice indicates that an FFI that receives withholdable payments solely through its U.S. branch will not be exempt from the requirement to enter into an FFI Agreement.⁶ With respect to withholdable payments received by a U.S. branch as an intermediary, Treasury and the IRS are considering permitting the U.S. branch to document its account holders under the requirements to be imposed on USFIs, described in the next paragraph.

Pursuant to the Notice, U.S. financial institutions (“USFIs”) will be required to make determinations similar to those required by participating FFIs. A USFI making withholdable payments to entities will need to determine whether to treat those entities as U.S. persons, FFIs, entities described in Section 1471(f) (e.g., foreign governments and international organizations), or NFFEs. Thereafter, a USFI must determine:

- (a) whether FFIs are to be treated as participating FFIs, deemed-compliant FFIs, or non-participating FFIs; and
- (b) whether NFFEs are to be treated as excepted NFFEs or as other NFFEs.

Treasury and the IRS, however, anticipate issuing regulations that include rules coordinating reporting required by USFIs with other U.S. tax reporting obligations to avoid duplicative reporting.

Information Collection

The Notice describes detailed procedures to be applied by participating FFIs and USFIs to make the above-described identifications. With respect to participating FFIs, the Notice distinguishes procedures for making such determinations with regard to the following four categories of accounts: (i) preexisting financial accounts held by individuals, (ii) new financial accounts held by individuals, (iii) preexisting financial accounts held by persons other than individuals, and (iv) new financial accounts held by persons other than individuals. With respect to USFIs, the Notice distinguishes procedures for making such determinations with regard to (i) preexisting entity accounts, and (ii) new entity accounts. The Notice indicates that FFIs will be permitted to rely on IRS Forms W-9 and W-8BEN. In addition, it is anticipated that the IRS will issue employer identification numbers (“EINs”) to participating FFIs and that participating FFIs will use these FFI EINs to identify themselves to withholding agents. In the interim, withholding agents and participating FFIs will be permitted to rely on certifications provided by FFIs as to their status as participating FFIs, unless the withholding agent or participating FFI knows or has reason to know that the certification provided is incorrect.

4. MANNER AND TYPE OF INFORMATION – REPORTING ON U.S. ACCOUNTS

Pursuant to an FFI Agreement, an FFI must report the following information with respect to each U.S. account:

- (a) the name, address and taxpayer identification number (“TIN”) of each account holder which is a specified U.S. person;
- (b) in the case of any account holder which is a U.S.-owned foreign entity, the name, address, and TIN of each substantial U.S. owner of such entity;

⁶ Payments received by a USFI for its own account that are effectively connected with a U.S. trade or business are generally excluded from the definition of withholdable payments.

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- (c) the account number (or other number the FFI assigns to the financial account that is unique and distinguishes the specific account);
- (d) the account balance or value. All amounts must be reported in U.S. dollars, and future guidance will provide appropriate currency translation methods. With respect to deposit and custodial accounts, Treasury and the IRS are considering requiring reporting of the highest month-end balances during the year; and
- (e) the gross receipts and gross withdrawals or payments from the account.

The IRS is developing a new form for reporting the information that will be filed electronically.

Requests by Treasury and the IRS for comments are included throughout the Notice and are not reproduced herein. All comments are due by November 1, 2010.

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