

Client Alert.

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IRS Announces Phased Implementation of FATCA

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On July 14, 2011, the Internal Revenue Service (“IRS”) and Treasury Department (“Treasury”) announced a phase-in schedule which effectively delays implementation of the Foreign Account Tax Compliance Act (“FATCA”)¹ for one year and, in some cases, until 2015. Notice 2011-53 (the “Notice”) will likely be welcomed by foreign financial institutions; however, it does not change the basic structure of the FATCA regime which is designed to enlist foreign financial institutions in the hunt for non-compliant U.S. taxpayers.

BACKGROUND

FATCA imposes a new 30% U.S. withholding tax on any U.S. source “withholdable payment” made on or after January 1, 2013 to a foreign financial institution (“FFI”).² The new 30% withholding tax 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.”

According to the Notice, after the IRS and Treasury published preliminary FATCA guidance in Notice 2010-60³ and supplemental guidance in Notice 2011-34,⁴ they received numerous comments concerning the practical aspects of implementing the FATCA rules by January 1, 2013. The comments identified challenges relating to the time required to develop compliance, reporting, and withholding systems necessary to comply with FATCA, Notice 2010-60, and Notice 2011-34.

Based on the comments received, the Notice states that the IRS and Treasury determined that FATCA creates the need for significant modifications to the information management systems of both FFIs and withholding agents. Accordingly, the Notice effectively replaces the FATCA January 1, 2013 deadline with a phased implementation approach.⁵

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

² The tax also applies to payments made to a non-financial foreign entity (“NFFE”) unless the NFFE discloses certain information regarding substantial U.S. owners.

³ Notice 2010-60 was released by the IRS and Treasury on August 29, 2010. See our prior client alert discussing Notice 2010-60 at <http://www.mofo.com/files/Uploads/Images/100910FACTA.pdf>.

⁴ Notice 2011-34 was released by the IRS and Treasury on April 8, 2011. See our prior client alert discussing Notice 2011-34 at <http://www.mofo.com/files/Uploads/Images/110420-IRS-Guidance-FATCA.pdf>.

⁵ IRS Commissioner Doug Shulman explained, “FATCA is an important development in U.S. efforts to combat offshore noncompliance. At the same time, the IRS recognizes that implementing FATCA is a major undertaking for financial institutions. [Notice 2011-53] is a reflection of [the IRS’s] serious commitment to implementation of the statute, but also a serious commitment to listen to the implementation challenges of affected financial institutions and make appropriate adjustments to ensure a smooth and timely roll-out.”

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THE NOTICE

The Notice's phased implementation timeline for FATCA breaks down as follows:

1. Participating FFIs

FATCA is constructed around the FFI Agreement which requires an FFI to provide the IRS with information about its U.S. account holders. The Notice announces that the IRS will begin accepting applications for FFI Agreements from FFIs through its electronic submissions process no later than January 1, 2013. In order to avoid potential withholding tax when FATCA withholding begins on January 1, 2014 (under the one year delay in the Notice) an FFI Agreement must be entered into by June 30, 2013. The June 30, 2013 deadline is designed to make sure there is enough time so that the relevant FFI is identified as a "participating FFI" by January 1, 2014. FFIs applying after June 30, 2013 are not assured they will be "in the system" as of January 1, 2014 and, therefore, may be subject to FATCA withholding when it is initially implemented. The Notice also provides that the effective date of an FFI Agreement entered into any time before July 1, 2013, will be July 1, 2013 and that the effective date of an FFI Agreement entered into on or after July 1, 2013, will be the date the FFI enters into the FFI Agreement. Among other things, the effective date is relevant for the application of the due diligence procedures described in the following paragraph.

In previous published guidance, due diligence procedures⁶ were provided in order for FFIs to identify U.S. accounts. The Notice provides a phased implementation for these due diligence procedures based on the type of account at issue. For all accounts (i) which opened prior to the effective date of the FFI's FFI Agreement, (ii) which are associated with a private banking relationship, and (iii) that have a balance/value of at least \$500,000 as of the FFI Agreement's effective date, a participating FFI is required to have completed the due diligence procedures within one year of its FFI Agreement's effective date. A participating FFI has until December 31, 2014, or one year following its FFI Agreement's effective date, to implement due diligence procedures for those private banking accounts with a balance/value of less than \$500,000 as of the FFI Agreement's effective date. For all other pre-existing accounts, a participating FFI has two years from its FFI Agreement's effective date to implement due diligence procedures. Thus, rather than requiring due diligence procedures to be effective on January 1, 2013, as many FFIs initially feared, the Notice grants participating FFIs additional time to implement such procedures in order to properly, and effectively, identify U.S. accounts.

2. Reporting

FATCA's main focus is on information reporting between FFIs and the IRS. While prior guidance provided information reporting procedures,⁷ the Notice acknowledges the challenges ahead for FFIs and loosens the information reporting requirements for a participating FFI's initial year of reporting. For those accounts for which a participating FFI has received a Form W-9 from the account holder by June 30, 2014, such account must be reported to the IRS as a "U.S. account" by September 30, 2014. Also, a participating FFI is only required to report the following information for the initial year of reporting: (i) the name, address, and U.S. taxpayer identification number ("TIN") of each specified U.S. person who is an account holder, and, in the case of any account holder that is a U.S.-owned foreign entity, the name, address, and U.S. TIN of each substantial U.S. owner of such entity; (ii) the account balance as of December 31, 2013 (or, if the account was closed after the FFI Agreement's effective date, the account balance immediately before its closure); and (iii) the account number.

⁶ Procedures are described in Step 3 of Section 1.A.2 of Notice 2011-34.

⁷ A participating FFI has the option to elect into the reporting requirements under Internal Revenue Code section 1471(c)(2).

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3. Withholding

To the surprise of many, rather than requiring that withholding commence on FATCA's January 1, 2013 effective date, the Notice states that regulations will implement such withholding in a delayed, two-phase approach. In phase one, withholding agents (including domestic, foreign and participating FFIs) will be required to withhold *only* on U.S. source FDAP⁸ payments made on or after January 1, 2014. In phase two, withholding agents will be required to withhold on *all* withholdable payments made on or after January 1, 2015, including "gross proceeds" (e.g., proceeds from sales of securities). Also, participating FFIs will not be required to withhold with respect to passthru payments⁹ made before January 1, 2015. Thus, the Notice provides participating FFIs and withholding agents an additional one to two years, depending on the source of the payment, to commence withholding.

4. "Grandfathered Obligations"

Unrelated to the phased implementation of FATCA, the Notice also discusses "grandfathered obligations."¹⁰ Numerous comments and questions have been raised regarding "obligations" and the Notice states that the term "obligation" will be clarified in future regulations as meaning any legal agreement that produces or could produce passthru payments (including withholdable payments), but not including any instrument treated as equity for U.S. tax purposes, or any legal agreement that lacks a definitive expiration or term. The Notice clarifies that a withholdable payment does, in fact, include passthru payments.

NEXT STEPS

Although the statute's effective date has not changed, as described above, the Notice grants participating FFIs and withholding agents additional time to comply with and implement FATCA information reporting requirements and withholding procedures. The Notice further provides that the IRS and Treasury anticipate issuing proposed regulations incorporating guidance provided in Notice 2010-60, Notice 2011-34, and the Notice by the end of 2011. Final regulations are currently planned to be published in the summer of 2012, along with an FFI Agreement and reporting forms for use by withholding agents and participating FFIs.

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⁸ "FDAP" stands for "fixed, determinable, annual, or periodical" income or payments and includes interest and dividends.

⁹ As explained in Notice 2011-34, passthru payments include (i) any withholdable payment and (ii) other payments to the extent attributable to a withholdable payment. An FFI is required to deduct and withhold 30% of any passthru payment made to a recalcitrant account holder (e.g., one who ignores requests for information) or non-participating FFI.

¹⁰ The Act provided that there shall not be any amount deducted or withheld from any payment under any obligation outstanding on March 18, 2012, or from the gross proceeds of any disposition of such an obligation.

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