

# Client Alert

February 2012

## Treasury Releases Proposed Regulations on FATCA

On February 8, 2012, the Treasury Department and the Internal Revenue Service (“IRS”) issued proposed regulations with respect to the Foreign Account Tax Compliance Act (“FATCA”). FATCA requires certain persons making payments to foreign financial institutions (“FFIs”) to withhold 30 percent of any payment (a “Withholdable Payment”) consisting of either (i) U.S. source income including interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration and certain other gains and profits (“Income Payments”) or (ii) gross proceeds from the sale of property that could produce interest or dividends from U.S. sources (“Proceeds Payments”). An FFI can avoid this withholding, however, if it enters into an agreement (a “Participation Agreement”) with the IRS to become a participating FFI (a “PFFI”) or is otherwise deemed compliant or exempt. A PFFI must identify its U.S. account holders and comply with IRS due diligence procedures. Additionally, PFFIs must withhold 30 percent of any passthru payment to a nonparticipating FFI or account holders who refuse to release their relevant information. A passthru payment is generally a portion of a payment made by an FFI that is attributable to a Withholdable Payment received by the PFFI (such as interest PFFIs earn and pay through to their account holders). FATCA also requires 30 percent withholding on any Withholdable Payments made to a nonfinancial foreign entity (“NFFE”), unless the NFFE either provides a U.S. beneficial ownership disclosure or is exempt.

The proposed regulations are complex and extensive. There are several provisions, however, that reduce or simplify certain compliance requirements beyond what had been provided in prior IRS guidance. In particular, the proposed regulations (i) expand the categories of FFIs that are “deemed compliant” or exempt and thus need not enter into agreements with the IRS, (ii) in some instances tie compliance information to data already required to be collected under anti-money laundering and “know your customer” rules and (iii) provide extended deadlines for the implementation of FATCA reporting and withholding requirements. The IRS will receive comments to the proposed regulations prior to April 30, 2012, and will hold a public hearing on May 15, 2012. The regulations generally would be effective when they are finalized.

### Prior Guidance

The IRS has previously issued several rounds of guidance with respect to FATCA. That guidance has included Notice 2010-60 (addressing general rules, definitional matters and certain grandfathered obligations), Notice 2011-34 (addressing passthru payments and FFI procedures for determining U.S. account holders) and Notice 2011-53 (describing timeline for implementation).<sup>1</sup>

### Summary of Important Dates

- Obligations outstanding as of January 1, 2013 (and related payments) and proceeds from dispositions of such obligations will generally be exempt from FATCA withholding.

---

<sup>1</sup> Copies of our prior Client Alerts addressing [Notice 2010-60](#) and [Notice 2011-34](#) are available here.

- FATCA withholding will generally apply to Income Payments after January 1, 2014, and Proceeds Payments after January 1, 2015.
- FATCA reporting in 2014 and 2015 (for the 2013 and 2014 calendar years) will be limited to names, addresses, taxpayer identification numbers and account balances of U.S. account holders.
- Beginning in 2016 (reporting for the 2015 calendar year), Income Payments will require full FATCA reporting and beginning in 2017 (reporting for the 2016 calendar year), Proceeds Payments will require full reporting.
- Until January 1, 2016, an FFI may register and become a PFFI even if other members of its affiliated group are located in jurisdictions that prohibit them from becoming PFFIs.
- Until January 1, 2017, PFFIs will not be obligated to withhold on passthru payments that are attributable to Withholdable Payments but are not themselves Withholdable Payments.

### **Cooperation with Foreign Governments**

Along with releasing the proposed regulations, the IRS has indicated that it intends to work closely with foreign governments in implementing FATCA. In that regard, on February 8, the Treasury Department issued a joint statement with the governments of France, Germany, Italy, Spain and the United Kingdom announcing intentions to develop a method for FATCA compliance based on disclosure to the FFI's resident country rather than to the U.S.

### **Expanded Categories of Deemed Compliant Entities and Exempt Entities**

Certain expanded categories of FFIs are deemed compliant or exempt and can avoid entering into a Participation Agreement with the IRS. Among others, these entities include certain local banks, nonprofits, retirement plans and entities wholly owned by otherwise exempt persons. Similar rules apply to establish exemption from the NFFE withholding requirements for entities that are not FFIs but might otherwise be covered under the FATCA rules applicable to NFFEs.

### **Affiliated Groups**

The IRS has indicated in prior guidance that in order for an FFI to qualify as a PFFI, all other FFIs within the entity's affiliated group must be PFFIs or otherwise be deemed compliant. Various countries have laws that effectively prohibit local entities from complying with certain FATCA requirements. In light of these local laws, the proposed regulations allow an FFI to become a PFFI even if other FFIs within its affiliated group are prevented from becoming PFFIs under local law (provided certain additional due diligence and reporting requirements are satisfied). This exception is transitional and will expire January 1, 2016.

### **Simplified Due Diligence and Administration**

U.S. account holder identification procedures described in the proposed regulations are somewhat simplified from procedures described in prior guidance. Under the proposed regulations, PFFIs can perform much of the diligence on preexisting accounts with electronic (as opposed to manual) review. This review would generally require searching records for U.S. connections (e.g., U.S. phone number or address). Preexisting accounts of less than \$50,000 (and in some cases \$250,000) are exempt from diligence requirements. Additionally, the due diligence procedures are designed to rely more heavily on information collected under existing "know your customer" and anti-money laundering laws. Procedures for new accounts are intended to look largely to information that the FFIs currently obtain for their own records.

Under the proposed regulations, FFI accounts subject to FATCA would generally exclude debt and equity issued by the FFI, provided the FFI is not an investment vehicle. Responsible officers of the FFI would be required to certify that the FFI has complied with the Participation Agreement but third-party audits are not

required. Also, FFIs would not have strict liability for failure to comply with their Participation Agreements. The IRS will likely issue a draft FFI Participation Agreement later this year and is developing an online process for registering as a PFFI.

### **Grandfathered Obligations**

Under the FATCA legislation, no amount is required to be deducted or withheld from any payment under any obligation outstanding on March 18, 2012, or from the gross proceeds from any disposition of such an obligation. The proposed regulations extend this date to provide that Withholdable Payments (or related passthru payments) do not include any payment made under obligations outstanding as of January 1, 2013, or from the gross proceeds from any disposition of such an obligation.

### **Extended Transition of Reporting and Withholding Requirements**

The proposed regulations establish a transition process for full reporting by FFIs on U.S. account holders. Reporting in 2014 and 2015 (for the 2013 and 2014 calendar years) will be limited to only names, addresses, taxpayer identification numbers and account balances of U.S. account holders. Starting in 2016 (reporting for the 2015 calendar year), Income Payments would require full reporting, and beginning in 2017 (reporting for the 2016 calendar year), Proceeds Payments would require full reporting.

Under FATCA, PFFIs are required to withhold on passthru payments to nonparticipating FFIs and account holders who refuse to release their information. Under the proposed regulations, PFFIs will not be required to withhold on foreign passthru payments until January 1, 2017. Nevertheless, if the passthru payment itself is an Income Payment, withholding will be required as of January 1, 2014, and if it is a Proceeds Payment, withholding will be required as of January 1, 2015. Prior to full implementation, PFFIs will be required to report certain payments made to nonparticipating FFIs.

### **Taxpayer Preparation**

Financial institutions should verify that their operations and record systems will be able to support the steps necessary to comply with the due diligence, information reporting and withholding obligations required by FATCA and described in the proposed regulations. Also, FATCA gives the IRS much greater ability to find U.S. taxpayers who are not reporting assets held overseas. In that regard, the proposed regulations also highlight the need for such noncompliant U.S. taxpayers to make voluntary disclosures before FATCA is fully implemented.

A copy of the [proposed regulations](#) is available here. If you would like to receive more information about the proposed regulations, please contact our firm.

**George C. Howell, III**  
ghowell@hunton.com

**Kendal A. Sibley**  
ksibley@hunton.com

**B. Cary Tolley, III**  
ctolley@hunton.com

**Joshua Z. Mishoe**  
jmishoe@hunton.com

**Cecelia Philipps Horner**  
chorner@hunton.com

**Mark A. Melton**  
mmelton@hunton.com

**Alexander G. McGeoch**  
amcgeoch@hunton.com

© 2012 Hunton & Williams LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.