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IRS Provides Further Guidance on New Withholding and Reporting Provisions

On April 8, 2011, the Internal Revenue Service ("IRS") issued Notice 2011-34 (the "Notice"), which supplements and revises previous IRS guidance in Notice 2010-60 regarding the implementation of the new withholding and reporting provisions in the Hiring Incentives to Restore Employment Act of 2010 (the "Act"), codified as sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended (the "Code"). The Notice addresses seven areas of concern for a foreign financial institution ("FFI"), which will be required to report the identity of its U.S. accounts to the IRS or face a 30 percent U.S. withholding tax on certain withholdable payments made to them by U.S. persons after December 31, 2012. Like Notice 2010-60, the Notice focuses solely on the application of the new rules to FFIs and does not address the application of those rules to nonfinancial foreign entities. Thus, many of the continuing questions about exemption from the application of the new provisions have yet to be answered.

Overview

The Notice provides guidance with respect to certain "priority concerns" identified by commentators following the release of Notice 2010-60. Those concerns include supplemental and/or revised guidance regarding (1) the

procedures to be followed by participating FFIs in identifying U.S. accounts among their pre-existing individual accounts, (2) the definition of the term passthru payment and the obligation of participating FFIs to withhold on such payments, (3) certain categories of FFIs that will be deemed compliant, (4) the obligation of participating FFIs to report with respect to U.S. accounts, (5) the treatment of qualified intermediaries ("QIs") under Code section 1471 and (6) the application of Code section 1471 to expanded affiliated groups. The Notice also requests further comments with respect to issues addressed in the Notice and other priority issues in connection with forthcoming guidance. The deadline for written comments is June 7, 2011.

As with Notice 2010-60, the Notice states that the Treasury Department and the IRS (collectively, "Treasury") intend to issue regulations incorporating the guidance provided in the Notice and addressing other matters necessary for the implementation of the new withholding and reporting provisions. In addition, the Notice reconfirms that Treasury intends to publish draft FFI agreements and draft information reporting and certification forms. The Notice states that FFI agreements will become effective on the later of the date they

are executed on January 1, 2013 (the "FFI Agreement Effective Date").

Pre-existing Individual Accounts

In response to concerns raised by commentators regarding the procedures set forth in Notice 2010-60, the Notice provides a revised six-step process that participating FFIs must use to identify U.S. accounts among their pre-existing financial accounts held by individuals. The Notice also introduces a new procedure under which an FFI's chief compliance officer, or other equivalent-level officer, will be required to certify to the IRS the FFI's completion of the six-step pre-existing individual account identification process. As part of these certifications, the responsible officer must certify that, between the date of the Notice and the FFI Agreement Effective Date, FFI management personnel did not engage in any activity, or have any formal or informal policies or procedures for, directing, encouraging or assisting account holders with respect to avoiding identification of their accounts as U.S. accounts.

Passthru Payments

The Notice provides guidance on the definition of a passthru payment and explains when participating FFIs must withhold on such payments. Code section 1471 defines a passthru payment as any withholdable payment or other payment to the extent attributable to a withholdable payment. The Notice provides that Treasury intends to issue regulations providing that a payment made by an FFI will be a passthru payment to the extent of: (1) the amount of the payment that is a withholdable payment plus (2) the amount of the

payment that is not a withholdable payment multiplied by the "passthru payment percentage" of the FFI. The Notice provides detailed instructions for calculating an FFI's passthru payment percentage using a formula based on the ratio of the FFI's "U.S. assets" to its total assets. Generally, a U.S. asset will be defined to include any asset to the extent that it is of the type that could produce a withholdable payment. The Notice provides that obligations outstanding on March 18, 2012 will not be treated as U.S. assets for purposes of determining an entity's passthru payment percentage.

Deemed-Compliant FFIs

The Notice provides that certain categories of FFIs will be deemed compliant for purposes of Code section 1471, including certain local banks, FFIs that are members of an expanded affiliate group including at least one participating FFI, certain collective investment vehicles and other investment funds to be identified in future guidance and certain foreign retirement plans. An FFI that meets the requirements provided in the Notice or in future regulations for treatment as a deemed-compliant FFI will have to apply for such status, obtain an employer identification number (an "FFI-EIN") and certify every three years that it meets the requirements for deemed-compliant FFI status.

Reporting on U.S. Accounts

The Notice provides that Treasury intends to issue regulations limiting an FFI's obligation to report account balances generally to year-end account balances or values. With respect to gross receipts and withdrawals, the

Notice provides that an FFI will be required to report only, with respect to depository and custodial accounts, the gross amount of dividends, interest and other income, as well as the gross proceeds from the sale or redemption of property paid or credited to the account, or, in the case of equity and debt interests in the FFI, the gross amount of all distributions, interest and similar amounts credited during the year and each redemption payment made during the year. If the FFI retains copies of statements sent to holders of U.S. accounts in the ordinary course of its business, it will be required pursuant to the FFI Agreement to retain such statements for a period of five years and provide them to the IRS on request. Finally, the Notice provides that Treasury intends to issue guidance providing that FFIs that are not U.S. payors and that report the information required under Code section 1471 with respect to U.S. accounts will not be required to report tax basis information required under Code section 6045(g) with respect to those accounts.

QIs, FWP's and FWT's

QIs that are also FFIs are subject to the requirements of Code section 1471 in addition to the reporting or other requirements imposed on QIs under other Code sections. The Notice provides that Treasury intends to issue guidance requiring all QIs to include in their QI agreements the requirement to become participating FFIs unless they qualify as deemed-compliant FFIs. This requirement will apply to any such QIs as of January 1, 2013. Treasury also intends to issue guidance that will impose a similar requirement on FFIs currently acting as foreign withholding partnerships

("FWPs") or foreign withholding trusts ("FWTs"). FFIs applying for QI, FWP or FWT status on or after January 1, 2013, will be required to satisfy the requirements of Code section 1471.

Expanded Affiliate Groups

The reporting, withholding and other requirements imposed on an FFI under Code section 1471 apply with respect to U.S. accounts maintained by the FFI and with respect to U.S. accounts maintained by each other FFI (each, an "FFI Affiliate") that is a member of the same "expanded affiliated group" (an "FFI Group"). The Notice provides that Treasury

intends to issue regulations requiring that each FFI Affiliate in an FFI Group be a participating FFI or a deemed-compliant FFI. Each FFI Affiliate will be required to execute, under coordinated execution procedures provided in the Notice, an FFI Agreement that will apply to all of its worldwide branches and offices. Generally, each participating FFI Affiliate will be responsible for its own due diligence, reporting and withholding obligations and return filing requirements with respect to its account holders and will be issued its own FFI-EIN. The Notice also states, however, that Treasury intends to provide FFI Groups with an option under which a designated FFI

could be appointed by some or all of the FFI Affiliates in the FFI Group to assume an oversight role with respect to compliance by the FFI Group with the Code section 1471 requirements and that Treasury is considering a similar centralized option for certain collective investment entities that are associated with a common asset manager or other agent.

A copy of [the Notice](#) is available here. A copy of [our Client Alert](#) regarding Notice 2010-60 is available here. If you would like to receive more information about the Notice, please contact our firm.

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