January 25, 2013

Foreign Account Tax Compliance Act ("FATCA") - Final Regulations

Last Friday, January 18, the Internal Revenue Service published long-anticipated Final Regulations under the Foreign Account Tax Compliance Act.[1] The Regulations will be effective on January 28.[2] FATCA has a significant impact on all foreign and domestic financial institutions. It requires a U.S. withholding agent to withhold a 30 percent tax on certain payments to foreign financial institutions ("FFIs") that do not agree to report certain information to the IRS concerning their U.S. accounts and on certain payments to non-financial foreign entities ("NFFEs") that do not provide certain information about their substantial U.S. owners.

Changes to 2012 Proposed Regulations

The Final Regulations make a number of changes to the extensive proposed regulations released last February, in response to comments received from the public. These changes are designed to target tax compliance concerns more specifically and to address practical considerations. To this end, the Final Regulations extend the initial date for information reporting under FATCA to March 31, 2015.

Specifically, under the Final Regulations:

- All debt obligations outstanding on January 1, 2014, are exempt from FATCA.
- Passive entities (such as trusts) that are not professionally managed will be treated as NFFEs, not FFIs.
- The categories of "deemed compliant" FFIs and retirement funds that are considered exempt are expanded.
- All pre-existing accounts held by individuals with balances of $50,000 or less are exempt from review. The threshold for review is raised to $250,000 for pre-existing accounts held by entities and for accounts that are cash value insurance or annuity contracts. Insurance contracts with a balance or value of $50,000 or less are not treated as "financial accounts."
- A participating FFI can determine whether pre-existing accounts with a balance of $1 million or less are U.S. accounts based solely on a search of electronically searchable account information for certain U.S. indicia. In cases of pre-existing accounts held by passive NFFEs, a withholding agent may rely on its review conducted for anti-money laundering ("AML") purposes.
- The ability of FFIs to rely on self-certification by entities holding accounts is expanded.
- All accounts maintained by an FFI prior to January 1, 2014, are treated as pre-existing accounts.
- The due date for the first information reporting by participating FFIs with respect to the 2013 and 2014 calendar years is modified to March 31, 2015.
- Foreign pass-through payments and gross proceeds from sales or dispositions of property occurring before January 1, 2017, are exempt from withholding.

Intergovernmental Agreements ("IGAs") Modify or Override Final Regulations

The Final Regulations promote the U.S. government's efforts to improve information reporting through intergovernmental agreements, which can override or modify the requirements of the FATCA Regulations.

The United States has developed two types of IGAs. Under a Model 1 IGA, FFIs must report information directly to their own governments. The United States has negotiated or is working on Model 1 agreements with numerous countries, including the U.K., Denmark, Mexico and Ireland. Under a Model 2 IGA, FFIs must register with the IRS and report directly to the IRS. The United States has negotiated or is working on Model 2 agreements with Switzerland and Japan.

FFIs covered by a Model 1 IGA will not need to apply the Final Regulations for purposes of complying with FATCA. FFIs covered by a Model 2 IGA will be required to apply the Final Regulations, except to the extent modified by the Model 2 IGA.

Administration

FFIs will be able to register with the IRS on a secure online web portal, the FATCA Registration Portal. Each FFI registering with the IRS will be assigned a Global Intermediary Identification Number ("GIIN"), which will be used to establish its status under FATCA and for reporting purposes under FATCA. The IRS will permit registration of FFIs as "Model 1 FFIs" or "Reporting Financial Institutions" under a Model 2 IGA if they are in jurisdictions identified on a list published by the IRS of countries treated as having in effect an IGA, even if the foreign jurisdiction has not completed ratification of the Model IGA.

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[1] FATCA, enacted by Congress in 2010, is found in Sections 1471 to 1474 of the Internal Revenue Code of 1986, as amended.

[2] The text of the final regulations appears at pages 142 to 543 of notice TD 9610, which also describes the background of the statute and the comments received on the proposed regulations and gives an explanation of the final regulations. TD 9610 can be found at www.irs.gov/PUP/businesses/corporations/TD9610.pdf.