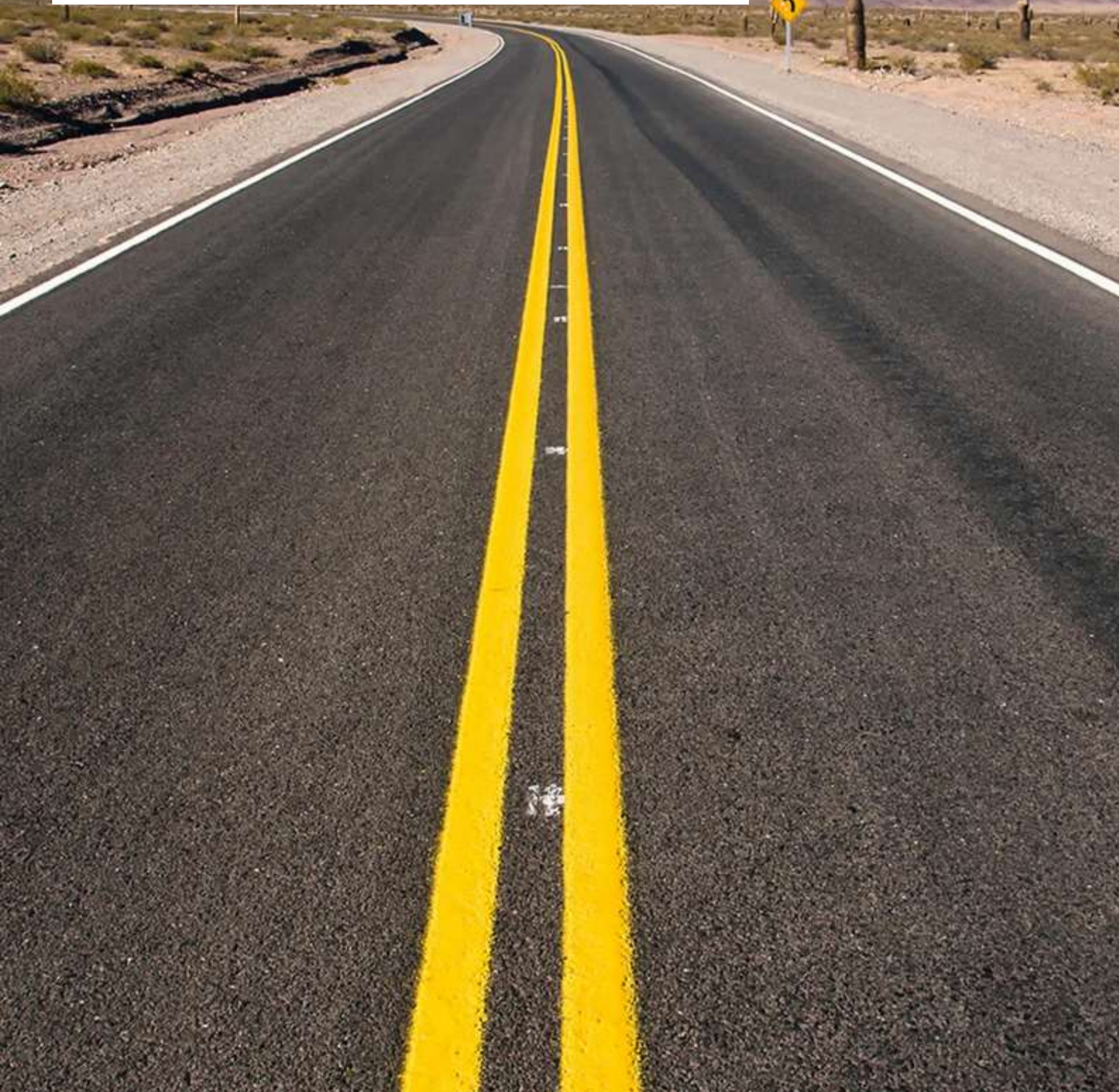
The Impact of FATCA on the non-financial services industry
Closing the distance

Global financial services industry



Overview

The Foreign Account Tax Compliance Act ("FATCA") is a U.S. tax law that has created one of the most extensive and complex tax information reporting regimes the world has seen. FATCA, and the Regulations issued by the U.S. Treasury pursuant to FATCA, have a global reach and impact virtually all multi-national organizations operating across every industry. FATCA's core objective is to address perceived abuses by U.S. taxpayers with respect to their offshore accounts and indirect investment income through non-U.S. entities. The regulations impact not only financial institutions but also non-financial companies that make U.S. source "withholdable payments" to non-U.S. entities. Financial Institutions globally are modifying client take-on procedures and related documentation requirements that affect virtually all of their customers. Furthermore, the regulations impose significant compliance burdens on payors making such cross-border payments and liability for any under withholding.

The reach of FATCA will require nearly every business with an international footprint or conducting business outside the U.S. to confront new compliance realities. Though the obvious impact of the new FATCA regime will be on businesses in the financial services industry, multinational non-financial services companies that are impacted will also be required to implement U.S. tax documentation, due diligence, reporting, and withholding processes among other FATCA requirements. The risk of non-compliance could be costly. The phase-in of FATCA withholding began on July 1, 2014 and could result in the application of FATCA withholding on certain U.S. source income, extending to certain gross proceeds in 2017.

The FATCA withholding tax will be imposed in a similar manner to the existing withholding tax on U.S. source income under Chapter 3 (sections 1441 and 1442) of the Internal Revenue Code by requiring payors (or withholding agents) of U.S. sourced income and gross proceeds to withhold 30% on payments to non-U.S. entities that do not certify their compliance with FATCA or disclose their substantial owners. However, FATCA withholding which is applied before any Chapter 3 withholding, does not allow tax treaty based exemptions or other reductions of the withholding tax rate. To avoid the tax, Foreign Financial Institutions ("FFIs") must generally enter into an FFI agreement with the IRS to share the identities of U.S. account and asset holders or, if subject to a model 1 intergovernmental agreement ("IGA"), register with the IRS as a reporting model 1 IGA FFI. The IGAs are agreements between the U.S. and foreign jurisdictions to implement FATCA compliance. FFIs that register with the IRS will obtain a Global Intermediary Identification Number (GIIN) to identify themselves as FATCA compliant to other withholding agents. Other affected non-financial foreign entities seeking to avoid the tax will be required to provide appropriate information to the withholding agents relating to any of their substantial U.S. owners or certify to a particular excepted status.

Implications of FATCA on non-financial services industry

The primary impact that FATCA will have on non-financial services companies is to deem them withholding agents for purposes of FATCA. Although there is an exception for certain non-financial payments made in the ordinary course of a business, many payments made by the non-financial services companies could be subject to FATCA withholding and reporting. At minimum, non-financial services companies will need to re-evaluate the current information reporting and withholding procedures and determine whether any are impacted by the new FATCA rules.

Those non-financial services companies that do not make withholdable payments will still be impacted as they find themselves confronted with requests from financial institutions where they hold accounts to certify their FATCA status.

Certain non-financial groups caught up in FATCA

A key aspect of FATCA is that it defines “financial institution” very broadly. Any non-U.S. entity conducting financial transactions may be considered an FFI. Therefore, multinational companies that have entities within their worldwide group that are not typically considered financial institutions could fall under the definition of an FFI under these rules.

A non-U.S. entity acting as a holding company, treasury center or captive finance company would generally fall within the definition of an FFI. However, it may be excluded if part of an excepted nonfinancial group. The primary purpose of this exception is to exclude from the definition those holding companies, treasury centers or captive finance companies considered to be an unlikely vehicle for a U.S. person to shield assets. Along those lines, a nonfinancial group is limited to holding 25% or less of its assets for the production of passive income and generating a limited amount of passive income over a period of time, among other things. The FATCA regulations should be carefully analyzed to determine whether the exception is applicable.

The excepted nonfinancial group exception does not apply if the affiliated group contains any private equity funds, venture capital funds, or similar investment vehicles established with an investment strategy to acquire or fund companies and to treat the interests in those companies as capital assets held for investment purposes. These rules were designed to ensure that holding companies and treasury centers cannot be used by financial groups with nonparticipating FFIs or limited FFIs to shelter payments from chapter 4 withholding. As a result, a holding company formed by a private investment fund to facilitate its investment structure may be subject to FATCA compliance even where such company solely holds an interest (directly or indirectly) in a single nonfinancial operating subsidiary.

Organizations should also consider analyzing any offshore pension or benefit plans maintained for their employees. Non-U.S. **pension and retirement plans** are generally FFIs and may be impacted by FATCA unless they meet exceptions under the final regulations or the intergovernmental agreements. However, the exceptions available under the regulations are limited. To protect employee benefit plans, organizations that maintain or sponsor such plans should ensure that the plans are either exempt or compliant under the relevant rules.

Withholdable payments to non-U.S. payees

A non-financial services company should determine whether it makes cross-border payments to non-U.S. entities that are deemed withholdable under FATCA. Withholdable payments include U.S. source fixed, determinable, annual and periodic payments (FDAP) like interest, dividends, premiums for insurance contracts or annuity contracts, investment advisory fees, custodial fees, and bank or brokerage fees, as well as gross proceeds from the sale of assets which could produce U.S. source dividends or interest. The FATCA regulations provide a broad exemption for nonfinancial payments defined as those for services (including wages and other forms of employee compensation (such as stock options)), the use of property, office and equipment leases, software licenses, transportation, freight, gambling winnings, awards, prizes, scholarships, and interest on outstanding accounts payable arising from the acquisition of goods or services.

Swaps, futures and other hedging transactions with non-U.S. counterparties can give rise to FATCA. Non-financial services companies will need to take a closer look at those relationships to make a determination as to whether they have to withholding tax and collect documentation from counterparties to substantiate FATCA compliance. If non-financial services companies determine that any counterparties are noncompliant, non-financial companies will need to develop and/or implement withholding and reporting capabilities.

Interest payments to non-U.S. lenders — A U.S. borrower who obtains a loan from a foreign financial institution that is not FATCA compliant may need to withhold on interest payments as well as on the repayment of the principal. There is an exception available for certain type of payments (i.e. the grandfathered obligation clause), but analysis will be necessary to determine the extent to which non-financial services companies can apply the exception, and controls will be required to track changes in contract terms which might undermine the efficacy of the exception.

Dividend payments and Stock/bond redemptions — Non-financial services companies that act as their own transfer agents and redeem stock, bonds or makes dividend payments will need to collect FATCA documentation from their shareholders. Any non-financial services companies who contract out dividend and redemption payments to third parties may be afforded some relief from FATCA liability and responsibility, but the company should consider controls and an indemnification in the event that the third party provider fails to properly comply with its delegated FATCA responsibilities. Technically, the nonfinancial service company is liable for any failure of its agent, such as failure to withhold or make a payment of tax even though the agent may be separately liable for its failure to comply with the FATCA rules. Ultimately, the same tax, interest or penalties cannot be collected more than once.

Non-financial foreign entity

From the receiving end, non-financial foreign entities (NFFEs) should be aware of their FATCA status so that they can provide appropriate documentation to their withholding agents if required. NFFEs are not required to enter into an FFI agreement; however, a withholdable payment made to an NFFE is subject to FATCA withholding unless the NFFE is treated as an active NFFE or certifies to the payor that it does not have any U.S. controlling persons or provides required information of each U.S. controlling persons to the payor. Under the Swiss IGA, active NFFEs such as publicly traded corporations, certain start-up companies, certain entities that are liquidating or emerging from bankruptcy, NFFEs engaged in an active trade or business and certain other payees are generally exempt from FATCA withholding if proper FATCA certification is provided. NFFEs that do not qualify as active NFFEs are classified as passive NFFEs under the Swiss IGA. A passive NFFE is required to disclose its U.S. controlling persons to a withholding agent who will use that information to report them to the IRS via Form 8966 reporting.

Next steps

Non-financial services entities should conduct a FATCA assessment to determine whether FATCA applies to their payment types and their operations, and if so, determine the changes required to comply with the new rules. A typical FATCA assessment includes the following:

- **Internal entity classification:** Classify the entities within the affiliated group to determine their status as U.S. withholding agents with respect to FATCA, FFIs, or NFFEs.
- **Impact assessment:** Based on the classification of the legal entities, identify the business units, operational areas, IT systems and legal documents (e.g. counterparty agreements, vendor contracts, etc.) impacted by FATCA. Operational areas that would be impacted include onboarding, payment processing, and tax withholding and depositing and regulatory reporting.
- **Payee classification:** Classify payees and other impacted relationships (e.g. counterparties for derivatives contracts) pursuant to the FATCA rules to identify documentation requirements.
- **Implementation planning:** Make business decisions that would reduce the implementation and ongoing costs for FATCA compliance. Leverage and modify existing chapter 3 processes and systems to further reduce implementation costs and business disruption.
- **Communication:** Communicate with internal and external stakeholders.
- **Governance:** Update policies, procedures and legal documents.

This assessment will also enable the entities to properly complete their FATCA status on the forms requested by their partner financial institutions.

Important FATCA dates from 2014 to 2016

2014	
May 05	Last date an FFI can register with IRS to ensure inclusion in the 02 June 2014 IRS FFI list
June 02	IRS published first "GIIN" list
July 01	Grandfathered obligations cutoff date
July 01	FFIs to begin new account onboarding, optional relief provided for new entity accounts onboarding under IRS Notice 2014-33
July 01	Begin income withholding (excluding certain offshore payment of U.S. source income)
December 31	FFIs to complete documenting/remediating pre-existing accounts that are considered "prima facie FFIs"
2015	
June 30	FFIs to have completed the review of high-value individual accounts and classified/documented them pursuant to the FATCA requirements. It is expected that documentation requests will start already in 2014
2016	
June 30	FFIs to have completed the review of all other accounts and classified/documented them pursuant to the FATCA requirements. It is expected that documentation requests will start already in 2014

**Other Withholding/Reporting requirements phase in from 2015 through 2018

To learn more

The final regulations are extensive and complicated, and the changes from the proposed regulations are substantial. This document attempts to highlight certain important provisions of the final regulations that generally impact U.S. and non-U.S. non-financial services companies and do not represent a broad-based summary of all of the changes. If you are or suspect that you are directly or indirectly affected by the compliance obligations of the final regulations, you should to take affirmative steps soon with respect to FATCA compliance. If you wish to discuss the final regulations or any FATCA related matters, please contact one of our FATCA contacts listed on the following pages.

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