

## Deloitte's point of view

# A perspective on the updated FATCA and coordination regulations

Global Financial Services Industry



### Deloitte's Point of View: Final and Temporary FATCA Regulations and Coordination Regulations

On February 20, 2014, the U.S. Treasury and Internal Revenue Service released temporary regulations that revise the Foreign Account Tax Compliance Act (FATCA) regulations (temporary FATCA regulations). Concurrently, the Treasury and IRS also released new temporary regulations coordinating the existing regulations under Chapters 3 and 61 and Section 3406 of the Internal Revenue Code (the Code) with the final and temporary FATCA regulations. These coordination regulations were issued as both temporary and proposed regulations, meaning they are in effect immediately as final regulations for a temporary period of three years, but also serve as proposed final regulations subject to commentary and revision before they can become final.

In this Point of View, we discuss some of the most significant final FATCA regulations updates and also some of the noteworthy coordinating changes to Chapters 3 and 61, and other related provisions.

### Coordination Regulations of Chapter 3, 4 and 61

Information reporting and withholding is a longstanding feature of the U.S. voluntary compliance-driven tax system. Prior to FATCA's advent, there were two primary chapters of the Code addressing non-wage information reporting and withholding obligations on payments made by U.S. persons (U.S. payors):

1. **Chapter 3** of the Code, which addresses information reporting and withholding on payments made to non-U.S. persons, typically reported on Forms 1042-S; and

2. **Chapter 61** of the Code, supplemented by backup withholding provisions in Section 3406 of the Code, which addresses information reporting and withholding on payments made to U.S. persons, typically reported on Forms 1099.

FATCA, codified in Chapter 4 of the Code, is primarily focused on obtaining information about U.S. taxpayers from foreign financial institutions (FFIs) and non-financial foreign entities (NFFEs). However, FATCA also imposes new information reporting and withholding obligations on U.S. payors, which were further clarified and expanded in new temporary regulations. These new information and reporting obligations necessitated updates to the existing Chapters 3 and 61 rules to coordinate with Chapter 4.

The following summary highlights various aspects of the coordination regulations emphasizing their impact on U.S. payors subject to withholding and reporting obligations under Chapters 3 and 61 of the Code, as well as Deloitte's point of view on these rules.

## Implementation timeframe

### No additional extension of time to comply with FATCA

FATCA requires U.S. payors and FFIs to apply enhanced due diligences procedures to new and existing accounts or payees and also perform new withholding and reporting on certain payments, accounts, or payees. Most notably, U.S. payors will be required to withhold at 30% on certain payments of U.S. source income paid to FFIs and NFFEs that do not comply with FATCA after June 30, 2014. The temporary FATCA regulations do not provide any extensions to this and the other FATCA deadlines previously delayed by Notice 2013-43.



#### Deloitte's point of view

FATCA set for July 1, 2014 go-live date

Although the IRS has suggested in the preamble to the temporary FATCA regulations that they may consider providing some transitional relief in the future, the release of the temporary FATCA regulations without any compliance deadline extensions demonstrates the IRS' expectation to make effective the FATCA regime without any further delay. U.S. payors and FFIs should accordingly continue to plan and execute their compliance upgrades to meet the previously articulated deadlines without any expectation of further delay.

### Transition to new requirements

The coordination regulations adopt and accommodate many of the new account/payee identification, reporting, and withholding concepts from the FATCA regulations. They also modify many existing rules under Chapters 3 and 61, such as allowing a non-U.S. resident to claim a reduced rate of withholding under a tax treaty using a foreign tax identifying number (TIN). The new requirements under the coordination regulations have immediate legal effect, but are generally applicable only to payments made after June 30, 2014.



### **Deloitte's point of view**

#### **Developing a flexible transition plan**

U.S. payors should develop a flexible transition plan to accommodate the new rules under the updated regulations, as the existing Chapters 3 and 61 rules will remain in effect for documentation, records, and policies with respect to payments made before June 30, 2014.

As an example, if the IRS were to initiate an audit in 2015 on a payment made before July 1, 2014 by a U.S. payor that was subject to withholding under Chapter 3, withholding determinations for such payment would be subject to the rules in effect before the coordination regulations were issued. Thus, a Form W-8 with a foreign TIN, but no U.S. TIN, that may support a reduced rate of withholding under a tax treaty on the same type of payment made during the time when the IRS audit was being conducted in 2015, may not be sufficient to support a reduced rate of withholding under a treaty on the same type of payment under IRS audit because it was made prior to July 1, 2014.

### **Payee identification**

#### **Account holder and payee onboarding and treatment harmonized**

FATCA created new due diligence requirements for withholding agents, such as the validation of an FFI's Global Intermediary Identification Number (GIIN), the coordination of account/payee information across multiple systems or related entities and the expansion of U.S. account/payee documentation collection beyond U.S. borders. As expected, the coordination regulations adopted many of the new FATCA concepts to create more uniform account holder/payee identification and documentation requirements across Chapters 3, 4 and 61.



### **Deloitte's point of view**

#### **Leveraging FATCA changes to conform other procedures**

Since FATCA has required organizations to examine current operating procedures and automated system protocols, we advise employing a more holistic approach. U.S. payors should be able to leverage efforts to upgrade FATCA processes and procedures to also comply with many of the changes in the coordination regulations. Many workstreams within current FATCA due diligence efforts may be streamlined to provide updated compliance with Chapters 3 and 61. For instance, the updates to onboarding efforts, including identification of payees, documentation collection and validation, storing of key information in an account holder/payee database, application of presumption rules, and classification of accounts may be uniform as a baseline for determining Chapters 3, 4 and 61 impacts for such accounts. The key information collected as part of the updated onboarding process will then flow-through to the withholding and reporting efforts under the separate tax regimes. Since the tax regimes are tied together by common efforts, FATCA due diligence cannot be considered in a vacuum separate from the other tax efforts, and changes for FATCA cannot be built completely independent, but must rather be layered over the other compliance efforts

## New rules for withholding certificates

Withholding certificates, including Forms W-8 and Form W-9, play an essential role in identifying payees and in establishing the withholding and reporting requirements of a given payment under Chapters 3, 4, and 61 of the Code. The FATCA regulations under Chapter 4 expanded and updated withholding certificate requirements under Chapters 3 and 61. As expected, the coordination regulations generally adopted these expanded and updated requirements to make them also applicable to payments not subject to FATCA withholding.



### Deloitte's point of view

#### Simplifying the documentation process

Some of these updates address specific FATCA purposes, but others reflect anecdotal commentary and other unofficial communications from the IRS of their intent to make management of withholding certificates simpler. Some of these updates have been incorporated into revised withholding certificates, including new Forms W-8 with FATCA-specific fields for identification and certification, as well as other non-FATCA specific fields. Some of the changes reflected in the coordination regulations affecting withholding certificates include:

- Codification of the ability to use an affidavit to cure documentation deficiencies after payment date, even to claim treaty benefits, as well as to cure minor errors or incomplete sections. This will result in reduced withholding for payees, but withholding agents should be wary of refund requests given the possibility of corrected post-payment documentation.
- Use of foreign TINs instead of a U.S. TIN for a valid claim of treaty benefits. This is expected to significantly simplify the valid claim of treaty benefits, as organizations are no longer required to obtain EINs and individuals are not required to obtain ITINs for this purpose. However, it is still expected that a U.S. TIN will be necessary for a beneficial owner of a payment to claim a refund in the event of overwithholding. This update will simplify the ability of the payee to obtain treaty benefits, but may require additional due diligence by the withholding agent, such as collecting and storing the foreign TIN. Withholding agents will also need to adapt to the new foreign TINs in their systems as their systems may not be capable of storing such information in the existing fields used for a U.S. TIN (i.e., differences in length, character types, etc.). Finally, if the IRS later requires validation of the foreign TIN, organizations may need to operationalize an approach to validate the wide-range of formats.
- Adopting the list of valid capacities articulated under Chapter 4 that are capable of signing a Form W-8 for Chapter 3 purposes.
- Extension of the validity period for withholding certificates until January 1, 2015. Pre-existing account holders/payees with withholding certificates whose three-year usage expires at the end of 2013 will be granted an extension through January 1, 2015 to avoid repapering of those set to be replaced in 2014. Automated processes for tracking expiration must be updated to accommodate this exception.
- Permitted use of substitute withholding certificates. Withholding agents can also opt to use substitute withholding certificates, which they may simplify for their purposes, including omitting non-applicable sections if they are not required for the withholding agents to determine a payee's FATCA status. Deloitte advises that any modifications to an IRS-prescribed form only be done when necessary or under well advised guidance to avoid IRS scrutiny of a substituted form at a future date.
- Permission for electronic transmission, receipt, and storage of withholding certificates and statements. This will increase efficiency with which forms are received, but it has also resulted in elimination of previously allowed lag time to cure errors in initial documentation efforts since updated forms can be received the same day as requested. If electronic documentation storage has not already been built into standard operations, it must be planned around given the updates to the regulations.

## Presumption rules

In the absence of valid withholding certificates, Chapters 3, 61, and 4 provide a set of presumption rules to determine the identity of a payee for withholding and reporting rules. The updated presumption rules applied under FATCA had to be conformed to Chapter 3 and Chapter 61 in the coordination regulations in order for standardized application of the appropriate rules to a particular undocumented account holder/payee. Additionally, the definitions section under each regime had to be updated to correspond with the definitions established under FATCA.

The updated regulations also permit a withholding agent to maintain current treatment of a U.S. exempt account holder/payee whose status was previously established via the now-defunct eyeball test. Going forward, the traditional eyeball test will not be permitted for determining the status of any new account holders/payees under the presumption rules.



### Deloitte's point of view

#### Updating presumption rule flows

From a process standardization perspective, these changes will require companies to update existing procedures related to opening accounts or setting up payees. For systems that have been programmed with internal checks for validation requirements and presumption rule logic, a revisit will be necessary to review which data fields are supported and how they are incorporated into the treatment of any particular account/payee. Even companies not engaged in financial transactions are advised to review current operations to confirm conformity with the changes in Chapter 3 and 61 regulations.

## Reporting and withholding

Chapter 3 reporting is typically applicable to U.S. payors and utilizes Forms 1042-S, while Chapter 61 reporting is also applicable to U.S. payors, but utilizes Forms 1099. The FATCA regulations introduced new reporting on Forms 8966 for FFIs to report activities of certain U.S. account holders, or certain substantial U.S. owners of NFFEs. FFIs, however, may meet the Chapter 61 definition of a U.S. payor, and thus be subject to Form 1099 reporting as well as backup withholding under Section 3406.

### Attempted elimination of duplicative Forms 8966 and 1099 reporting

Since FATCA requires information reporting on transactions that may be currently subject to Form 1099 reporting by FFIs, the coordination regulations attempt to reduce duplicative reporting to the extent that the legislative intent is adequately served by one reporting method. For instance, FFIs may be able to mitigate duplicative reporting by electing to satisfy their FATCA Form 8966 reporting obligations. They can do this through enhanced Form 1099 reporting, meaning they report not only payments just as a U.S. payor would, but they also effectively look through some of their payees to report the underlying owners of the payee, including reporting on substantial U.S. owners of passive NFFEs, and owners of certified deemed compliant FFIs. (Note however, that such Form 1099 reporting may not eliminate any FFI reporting requirements under a Model 1 Intergovernmental Agreement [IGA]).

The coordination regulations also allow, in very limited cases, for an FFI that is also subject to Chapter 61 reporting on a Form 1099 to satisfy those obligations by reporting information on Form 8966.

Reporting under Chapters 3 and 4 will both utilize Forms 1042-S, so there is little chance for duplicative reporting under those regimes. However, Chapter 4 necessitates significant Form 1042-S changes to accommodate FATCA, and allows new instances of withholding that U.S. payors must accommodate and develop controls to account for, even if they are not making FATCA withholdable payments.

IRS efforts to eliminate duplicative efforts under the different tax regimes are not limited to reporting, as similar exceptions were included for overlapping withholding efforts. For instance, participating FFIs (including reporting Model 2 IGA FFIs) and registered deemed-compliant FFIs can satisfy their FATCA withholding requirements by electing to continue to perform backup withholding under Section 3406 at the 28% withholding rate in circumstance where the other requirements of Chapter 61 and Section 3406 will be met.



### **Deloitte's point of view**

#### **Reporting relief is very limited**

On first impression, this effort to reduce duplicative reporting is welcome relief, but upon further analysis it may only apply to a very limited set of payments made by U.S. payors involving offshore obligations. The limitation on the exception appears driven by the fact that the legislative intent of Form 1099 reporting is not congruent with Form 8966 reporting (i.e., under Chapter 61, the payor must furnish a Form 1099 to the recipient, which facilitates voluntary compliance, whereas there is no similar provision under FATCA).

Implementing these exceptions on an automated basis may prove difficult for many organizations, as eligibility for the exceptions can be nuanced. As a result, organizations should consider the following questions:

- Are we eligible to use these exceptions to reduce our reporting and withholding obligations?
- If we are eligible, do we wish to take advantage of these exceptions at the expense of intervening with otherwise established/automated processes?
- What are the internal benefits to our organization of such exceptions?

To the extent that the costs of these exceptions exceed their potential usefulness, organizations may consider forgoing them.

## **Impact on existing processes**

### **Updates necessary for policies and systems**

FATCA was enacted with the intent of compelling greater compliance from U.S. taxpayers with offshore assets, but it has had a ripple effect reaching beyond the financial services industry ("industry"). Chapters 3 and 61 information reporting and withholding have impacts on all financial and non-financial industries and modification to existing law will require adjustment of existing processes for all U.S. payors. Companies with account/payee opening and maintenance policy and procedure manuals are encouraged to make revisions to reflect the changes in these regulations. For systems programmed with internal checks, presumption rule logic and other automated components, the current data mapping should be revisited to determine which data fields are supported and how they are incorporated into the treatment of any particular account/payee. Just as the government has had to revamp its regulations under Chapters 3 and 61 to coordinate with FATCA, companies should use their current FATCA assessment and development period as a time to evaluate their current information and reporting practices and make appropriate adjustments.

## **Updated FATCA Regulations (Temporary Regulations)**

### **Modifications to definitions affecting classification of entities**

The temporary regulations modify and add certain definitions to the final regulations that impact the classification of entities:

#### **Nonfinancial group exception — holding companies, treasury centers, or captive finance entities availed by an investment vehicle**

The nonfinancial group exception has been modified in the case of a holding company, treasury center, or captive finance entity that has been recently acquired by an investment entity or similar arrangement. Under the prior regulations, such entities would not qualify for the nonfinancial group exception if owned by an investment vehicle or similar arrangement because the vehicle or arrangement could be considered availed by such entity. Under the revised regulations, if the entity was in existence for 6 months prior to the acquisition and regularly conducted activities in the ordinary course of business, it will still qualify for the nonfinancial group exception in the absence of an investment strategy.



#### **Deloitte's point of view**

##### **Nonfinancial groups should revisit this exception in light of new rule aimed at reducing FFIs in private equity structures**

This update to the nonfinancial group exception is a welcome change that may help further reduce the number of FFIs for many entities, particularly for holding companies, treasury centers or captive finance entities that could avail themselves of the nonfinancial group exception but for the fact that they were acquired by a private equity fund, venture capital fund, or similar investment vehicle. This is especially important given the rise of private equity and other investment funds purchasing substantial majority interests in existing operating companies.

Nonfinancial groups that have been acquired by an investment vehicle or have such a vehicle in their expanded affiliated group should revisit whether their holding companies, treasury centers, or captive finance centers can qualify for the nonfinancial group exception.

#### **Insurance companies**

The term "U.S. person" now includes a foreign insurance company that has made an election under Code section 953(d), provided that either the foreign insurance company is not a specified insurance company or the foreign insurance company is a specified insurance company and is licensed to do business in any state. A specified insurance company that is not licensed to do business in any state will continue to be treated as a foreign person under the final regulations.



#### **Deloitte's point of view**

##### **U.S. withholding agents may need to revisit documentation for non-U.S. insurance companies.**

Although this is generally good news for insurance companies outside of the U.S., those withholding agents in the U.S. having to document the insurance companies to which they pay premiums may have a difficult time determining whether the documentation received from such entities is valid. In general, a U.S. withholding agent may know whether an insurance company outside of the U.S. (particularly one offering life insurance or annuities) is an FFI. However, the U.S. withholding agent may not be able to determine whether it can accept a Form W-9 from such an entity because it will not be apparent whether the insurance company has made a section 953(d) election. In practice, this information gap may require a cautious U.S. withholding agent to separately ask the insurance company whether it made such an election and perhaps, for highly cautious U.S. withholding agents, require the insurance company to provide proof of such election.

## CLOs, CDOs, and other similar investment vehicles

The requirements for an entity to be considered a limited life debt investment entity (LLDIE) have been liberalized to expand the types of securitization vehicles that will qualify as a LLDIE. The changes include the removal of the requirement that the LLDIE's organizational documents cannot be amended without the consent of all investors.



### Deloitte's point of view

#### The modified limited life debt investment entity status is easier to satisfy, but may not be enough for many investment entities to qualify

Many in industry commented that most existing investment vehicles could not meet the strict requirements set out in the original regulations for the certified deemed compliant status for limited life debt investment vehicles, particularly with respect to CLOs, CDOs, and other similar investment vehicles. The IRS responded in the updated regulations by easing many of the restrictions, including: removing the requirement that investors be unrelated; allowing pre-existing vehicles formed as of January 17, 2013 (the publication of the original final FATCA regulations) as opposed to December 31, 2011; and removing the January 1, 2017 expiration date for the status and allowing the exception until the vehicle liquidates or terminates. However, many restrictions still exist. Despite IRS statements in the preamble to the updated regulations indicating that the new changes expand the types of assets that can be held by the investment vehicle, the LLDIE status still requires that substantially all of its assets consist of debt instruments. That may be problematic for many older vehicles that hold equity instruments as well as debt. Moreover, the word "substantially" is undefined, leaving some uncertainty to the percentage of debt instruments needed to qualify.

Finally, as a precondition to qualification, the LLDIE status still requires that the fiduciary or trustee not be able to comply with the requirements of a participating FFI. Although industry was seeking to have this rule relaxed, the IRS understandably declined given that the primary purpose of the certified deemed compliant status is to ease the FATCA burden for trustees or fiduciaries that simply could not comply due to restrictions on their authority to comply with FATCA. However, the IRS did provide some relief by eliminating the requirement that the LLDIE's organizational document could not be amended without consent of all investors. Given the significant changes to the requirements for LLDIE status, entities that utilize CLOs, CDOs, and similar investment vehicles should reanalyze whether their investment vehicles may qualify for the status.

## Expanded affiliated group also redefined

### Expanded affiliated groups

The temporary regulations modify the definition of an expanded affiliated group (EAG) to allow a partnership or other non-corporate entity to elect to be treated as the common parent entity of an EAG. The temporary regulations also set forth new rules for establishing the ownership requirements for determining if an entity is a member of an EAG. For example, a partnership or other non-corporate entity that owns a corporation can now be included in that corporation's chain of entities that is part of the same EAG. Further, in determining whether an entity is an EAG member, only direct — not indirect or constructive — ownership is considered.



### **Deloitte's point of view**

#### **The expanded affiliated group rule changes may help certain entities but further complicate these rules**

The EAG concept was designed to enable the IRS to enforce compliance to a broad group of entities. The enabling component behind this concept is the rule that a FFI cannot be considered a participating FFI or otherwise deemed compliant if there is a member in the EAG that is not compliant or otherwise exempt from the rules. The original regulations relied on a set of rules (the Code section 1504(b) rules) that unintentionally left entities outside an EAG if the common parent of the group was not a corporation. In many cases, this may have resulted in no EAG if there was no corporate entity in the affiliated structure or created mini-EAGs within the structure if there were corporations within the structure but no common corporate parent. This inconsistency was not what the IRS originally intended and often complicated the implementation of the EAG rules.

Unfortunately, the change in the updated regulations did not provide certainty. The regulations instead made the election to treat a non-corporate common parent as a corporation for EAG determination an optional election. Understandably, the change was made elective so that companies that may have already begun legal entity registration since were not unfairly burdened by the change in the rules mid-stream would have been an unfair burden. However, the new rule will likely create more inconsistency and exceptions to exceptions for the FATCA regulations.

Industry entities must now decide whether to make such an election. The upside is that it may simplify registration for affiliated groups and allow certain entities to rely on the nonfinancial group exception that requires the entity to be part of an expanded affiliated group. The downside could be a more complicated compliance program structure and, for groups containing FFIs that will not be compliant, may cause an issue with the rule that all FFIs in the EAG must be compliant or exempt. Moreover, the election decision cannot be easily changed; once the election is made, it cannot be changed without IRS approval. Clients should carefully weigh the pros and cons of the election before making a decision.

### **Treatment of disregarded entities**

#### **Branches**

The term branch with respect to an FFI has been modified to include an entity that is a disregarded entity separate from the FFI. The GIIN verification procedures that apply with respect to a branch of an FFI also apply to a disregarded entity that is owned by an FFI. Moreover, a disregarded entity of an FFI can be a limited branch. Finally, all units, businesses, offices and all disregarded entities of participating FFIs located in a single country are treated as a single branch and may use the same GIIN.



### **Deloitte's point of view**

#### **While the changes to the branch definition to include a disregarded entity of an FFI help those entities specifically, the new regulations did not clarify other issues with disregarded entities**

In some respects, the IRS has provided much-needed clarification on how disregarded entities are to be treated under the regulations. However, the changes leave certain issues open. First, the rules indicate that a disregarded entity is only treated as a branch if it is a disregarded entity of an FFI. This means that disregarded entities of a USFI must be treated as separate legal entities for registration purposes. Although this is not a significant impact, it does further complicate the rules.

Second, many in industry were hoping for clarification as to the treatment of a holding company that primarily holds interests in a disregarded entity that was created to hold real property. This is a common structure for real estate investment structures and investment structures for hard assets (e.g., planes, shipping containers, etc.) If the holding company was simply holding the hard asset or real estate directly, it would not be considered a holding company FFI under the regulations. However, because there is an entity between the holding company and the property, the holding company could be considered a holding company FFI. In most cases, the disregarded entity must be created to hold the property for tax reasons or due to local property ownership restrictions. Some were hoping that the holding company would be treated as if it were holding the real property directly and not shares in the disregarded entity; thereby avoiding a classification of FFI (assuming it did not otherwise fall under the investment entity definition). Unfortunately, the updated regulations did not adopt this view and these holding companies, most of which do not have outside investors, will have to register as participating FFIs if they are located outside an IGA jurisdiction (the IGAs do not have the holding company definition of an FFI thus creating additional disparate treatment).

Finally, some may contend that the holding company can be treated as holding the interests in the real property if the disregarded entity is treated as a branch. However, the narrow definition of a branch, whereby it will only apply to the disregarded entity of an FFI, does not permit the disregarded entity to be treated as a branch because technically the holding company isn't an FFI. This creates a bit of a circular argument — you can't treat the disregarded entity as a branch to classify the holding company because it's not an FFI, but once you classify the holding company as an FFI for holding interests in the disregarded entity, the disregarded entity can be treated as a branch for certain purposes.

### **Modifications to events of default — Generally no longer required to close accounts**

#### **Events of default**

The temporary regulations clarify that an event of default for failing to significantly reduce, over a period of time, the number of account holders or payees of a Participating Foreign Financial Institution (PFFI) that must be treated as recalcitrant account holders or nonparticipating FFIs occurs only if the PFFI failed to actually comply with the due diligence procedures for the identification and documentation of account holders and payees as set forth in the FFI Agreement.



### **Deloitte's point of view**

**Relief was provided with respect to closing accounts of recalcitrant account holders or non-participating FFIs, but participating FFIs should analyze whether they should adopt policies to close accounts when not doing otherwise may trigger withholding responsibilities**

Up until the revision to the regulations, participating FFIs were required to close accounts of recalcitrant account holders and nonparticipating FFIs within a reasonable period of time. Under this revision, account closure is no longer required as long as the participating FFI is able to withhold on payments to the non-compliant account under the laws of its jurisdiction. Moreover in most cases, the participating FFI would not have to withhold before 2017 because only U.S. source payments are withholdable, and generally the participating FFI receives such payments as an intermediary and the immediate payor of the income would have the withholding responsibility (subject to any residual withholding requirement if the immediate payor does not withhold properly).

It is unclear what would happen if the jurisdiction does not allow the participating FFI to withhold, but the participating FFI provides the immediate payor with the information required for the payor to perform withholding. Would that be sufficient to allow the FFI to not close an account? What if the immediate payor under-withholds and refuses to correct the issue requiring the FFI to do the withholding that it cannot legally perform? These questions should be analyzed to determine whether a participating FFI should adopt a policy to close certain recalcitrant or non-participating FFI accounts.

This change may also diminish FATCA's ability to improve compliance. Under the old rule, FFIs that did not receive U.S. source income were still hesitant to be non-compliant because it would be difficult to open financial accounts and maintain existing accounts. If participating FFIs take a liberal view and choose not to close accounts, there will be less incentive for non-compliant entities to become compliant; diminishing the overall power of FATCA. The extent of this may vary by local law and how participating FFIs implement their FATCA programs. Moreover, the increase in IGA activity will likely diminish the effect of this new change, because entities will have local law as incentive to comply (another potential reason as to why the IRS made the concession).

## **Due diligence**

### **Identification of U.S. persons — presumption rules for pre-existing obligations**

The final regulations required a U.S. withholding agent that made a payment with respect to a pre-existing obligation to treat the payee as a U.S. person only if it previously reviewed a Form W-9 or other documentation that established the payee as a U.S. person that was an exempt recipient under Chapter 61. The Temporary Regulations modify this rule to allow U.S. withholding agents to treat a payee as a U.S. person if the withholding agent has previously established, either through documentation or the application of the eyeball test and other rules set forth in Treas. Reg. § 1.6049-4(c)(1)(ii), that the payee is an exempt recipient for purposes of Chapter 61. This rule is only applicable for pre-existing obligations. U.S. withholding agents will be required to collect Forms W-9 or other documentation to establish the exempt recipient status of new account holders.



### **Deloitte's point of view**

**Although the traditional eyeball test is gone, some relief for existing accounts was provided. Withholding agents should still be wary.**

Industry was very vocal against the repeal of the eyeball test, particularly because it applied to pre-existing obligations. The concern was that withholding agents faced a daunting task of attempting to document thousands of payees. If documentation was not obtained within the applicable grace period, these payees would generally be treated as non-participating FFIs for FATCA purposes. If FATCA withholding was applied as a result of the presumption rules, many U.S. banks and corporations would face a difficult time trying to reclaim the withheld tax.

Fortunately the IRS changed its position and allowed pre-existing obligations that were properly treated as exempt recipients under Chapter 61 to be exempt from documentation requirements. However, withholding agents should be aware that the exception only applies if the entity is properly treated as an exempt recipient under Chapter 61. It is not uncommon (particularly in the non-financial space) for withholding agents to incorrectly apply the rule to entities such as partnerships or limited liability corporations, which led to the IRS change of the rule. The new exception may give withholding agents a false sense of security with respect to payees previously treated as exempt recipients. Therefore, withholding agents should confirm that previous procedures were detailed enough to prevent misuse of the exemption. If procedures were non-existent, loosely followed, or insufficiently detailed, withholding agents should conduct an internal analysis to determine whether any of their existing payees need to be documented as U.S. persons.

## **Reporting**

### **Transitional reporting to nonparticipating FFIs**

The temporary regulations incorporate the changes announced in Notice 2013-69 and the final FFI Agreement regarding the transitional reporting of foreign reportable amounts paid to nonparticipating FFIs. The transitional reporting applies only with respect to payments made to a nonparticipating FFI that maintains an account with the PFFI, and allows the PFFI to report all payments made with respect to an account, not just payments of foreign reportable amounts. The temporary regulations also modify the definition of a foreign reportable amount to mean foreign source payments as described in Treas. Reg. § 1.1471-(d)(4)(iv) paid to or with respect to an account.



### Deloitte's point of view

#### **The new regulations limit reporting to financial accounts (unless a withholdable payment is made), but inconsistencies exist in IGA countries and the definition of a financial account in the derivative contract context is unclear**

The limitation of reporting only payments made to financial accounts held by nonparticipating FFIs versus any payments made to a nonparticipating FFI is a significant change to a participating FFI's reporting obligations. (unless a withholdable payment is made) The prior rule would require reporting if a payment (whether withholdable or not) was made to a nonparticipating FFI. This will also help alleviate certain reporting responsibilities for payments made under certain derivative contracts to the extent the contract is not treated as a financial account for FATCA purposes. Whether a derivative contract itself is a financial account is still subject to debate by many in industry. Many financial institutions take the conservative position that if it must create an account in its books and records to manage obligations under a derivative contract, it will treat such account as a custodial account. However, if collateral is posted to the account by a counterparty, industry generally agrees that it must treat the account as a custodial account. However, for contracts where collateral is not posted and where the financial institution has taken a more liberal view of the financial account definition (or no formal account is created in the financial institution's books and records), the new rule will help alleviate this temporary reporting requirement.

Although this rule may alleviate some reporting responsibilities for non-IGA FFIs, the Model IGAs continue to require reporting on payments to non-participating FFIs, irrespective of whether they are tied to a financial account. Although Model 1 jurisdictions have the option to apply exceptions provided in the U.S. FATCA regulations, some jurisdictions may not make the election. This inconsistency may create significant headaches for multinational financial institutions and service providers operating under both IGA and non-IGA jurisdictions. One potential approach may be to become over-inclusive and report on payments to all non-participating FFIs, if building system capability to support both regimes proves difficult.

### Closing comments

While the temporary and final regulations bring welcome relief and closure in some respects, many open questions remain. In fact, many of the rules are still temporary and subject to change. If it wasn't clear before, it should be clear now — FATCA continues to evolve and will continue to change over the next several years. Organizations impacted by FATCA should remain vigilant as additional guidance is released and issues arise. The better informed your organization is, the better prepared it will be for the evolving global information reporting age.

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