The road ahead

Thoughts on the final FATCA regulations

On January 17, 2013, the U.S. Treasury Department and Inland Revenue Service (IRS) released the long-awaited final regulations for the Foreign Account Tax Compliance Act (FATCA) and in so doing are attempting to provide a balanced and integrated method for implementing this law and a risk-based approach that effectively addresses policy, eliminates burdens and builds on existing practices and procedures.

FATCA, codified as Chapter 4 of the Internal Revenue Code, represents the United States Government's efforts to prevent U.S. taxpayers who hold financial assets in non-U.S. financial institutions (foreign financial institutions or FFIs) and other offshore vehicles from avoiding their U.S. tax obligations.

As of January 2014, virtually all non-U.S. financial intermediaries and withholding agents that own or hold U.S. investments will be subject to its information reporting and disclosure requirements. This U.S. legislation will greatly impact organizations' tax functions, technology systems, operations and business strategy.

So what are the modifications to the earlier guidance rules? Below is a summary highlighting several of the specific takeaways from the 544 pages making up the final regulations and preamble.

The Treasury emphasized the adoption of a risk-based approach to address policy considerations and eliminate unnecessary burdens

Treasury's risk-based approach limits institutions, obligations and accounts subject to FATCA

The Treasury emphasized the adoption of a risk-based approach to address policy considerations and eliminate unnecessary burdens. To that end, the regulations:

- Introduce new categories of deemed-compliant FFIs (certain qualified credit card issuers, sponsored FFIs and limited-life debt investment entities),
- Move certain existing categories (retirement funds to definition of exempt beneficial owner and certain non- profit organizations) to a category of excepted non- financial foreign entities (NFFEs),
- Provide greater clarity on conditions to qualify as deemed-compliant FFIs, treat certain passive entities not professionally managed as NFFEs rather than FFIs and,
- Provide an exemption for financial institutions and passive NFFEs that are part of a non-financial group of companies.

While the Treasury's efforts to adopt this risk-based approach succeed, in some part, at limiting the institutions, obligations and accounts subject to FATCA, a consistent and robust approach is still required to successfully manage, remediate and document accounts under the FATCA regime.

Collaboration with foreign governments is a leap towards a global information reporting framework

The guidance also addresses the coordination of the Intergovernmental Agreements (IGAs) and the regulations by making it clear that foreign financial institutions (FFIs) in Model 1 jurisdictions (i.e. countries entering into so-called "Model 1" IGAs will be governed by the laws implemented by their own countries while those in Model 2 jurisdictions (i.e. countries entering into "Model 2" IGAs) will need to follow the regulations in order to achieve compliance.

Perhaps first initiated to remove compliance impediments posed by privacy laws, the Intergovernmental Agreement (IGA) model has essentially moved towards a global information reporting framework. This is clearly evident in the final regulations, which introduce the Global Intermediary Identification Number (GIIN)[1] and mention the possibility of adopting a single format for reporting FATCA information, whether that information is reported directly to the IRS or to the tax administration in a Model 1 IGA jurisdiction. The Treasury also places great emphasis on the relationship with the two forms of IGAs (Model 1 and Model 2). In particular, the final regulations make clear that FFIs in Model 1 IGA jurisdictions will be governed by the laws in force in their own countries, while those in Model 2 IGA jurisdictions will follow the final regulations. However, the final regulations leave open the opportunity for foreign governments to negotiate with Treasury for inclusion of IGA terms that would benefit or protect entities within their jurisdictions from the requirements of the final regulations. Accordingly, the final regulations' emphasis on IGAs may signify Treasury's realization that IGAs – and not the final regulations – may be the path forward to achieve FATCA's goal and establish a global information reporting framework.

Registration and technical implementation questions addressed

The final regulations also provide much anticipated guidance on the administrative responsibilities of FFIs, including details on the responsibilities that will be contained in the FFI agreements, timelines for paperless registration through the FATCA Registration Portal and issuance of the aforementioned GIIN.

Provisions on account documentation and due diligence requirements relieve some burden

Perhaps the greatest efforts to streamline the FATCA compliance burden are found in the sections pertaining to the requirements for account documentation and due diligence. Under certain circumstances, provisions partially reinvigorate the "eyeball test" and allow for the use of substitute and non-IRS Forms, including forms prepared in different languages, reliance on Pre-FATCA Forms W-8,[2] written statements in lieu of withholding certificates, permanent validity of documentation as well as the opportunity to cure inconsequential errors in withholding certificates. Additionally, under specified conditions, the final regulations also allow withholding agents to rely on the same documentation for multiple accounts held by the same account holder and permit new accounts of an existing customer to be treated as pre-existing obligations (allowing additional time to collect requisite documentation) where the obligations are treated as one obligation.

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These modifications, in addition to several changes to the applicable standards of knowledge, should have a positive impact on the duty to comply with FATCA's documentation and due diligence requirements.

Rules on withholding provide clarity on certain issues but leave others ambiguous

The final provisions on withholding answer certain questions but leave others unresolved. The rules provide additional guidance on the election to be withheld upon and permit this election to be made on an account-by-account basis. With respect to grandfathered obligations, the regulations modify the scope of grandfathered obligations to include any obligations outstanding on January 1, 2014 (previously January 1, 2013) and simplify the withholding agent's ability to determine whether an obligation is grandfathered. With respect to payments that may be withheld and the definition thereof, the Treasury Department has not addressed several of the issues with respect to Gross Proceeds, in addition to remaining nearly silent on foreign passthru payments. As anticipated, Treasury did adopt a revised timeline for Gross Proceeds withholding to January 1, 2017. However, the regulations provided limited additional guidance on gross proceeds (the rules do, however, reserve the ability to elect to be withheld upon for gross proceeds), including on the much commented issue of withholding in "delivery versus payment" or "cash on delivery" transactions and the proposed imposition of withholding responsibilities on qualified clearing organizations (although Treasury did include a reserved section to provide guidance on this issue). Treasury's decision to reserve on these issues may mean that additional guidance should be expected though may not be forthcoming before 2017.

As anticipated, the Treasury Department did address the exception for ordinary course of business payments by replacing this exception with a list of excluded non-financial payments. However, Treasury's characterization of this list as "comprehensive" begs the question as to whether this list is indeed exhaustive and does not address how certain payments not contemplated in this list will be treated. Accordingly, while the provisions on withholding do provide significant guidance on certain withholding responsibilities and types of payments for which withholding will be required, the regulations do not provide clarity on a number of issues.

Reporting provisions unchanged

The final regulations provide scant additional guidance with respect to reporting requirements, with the exception of adopting a modified date for participating FFIs to report on U.S. accounts. However, Treasury did express an intention to release several new and modified forms, including Form 8966 to be used for FFI reporting and revised Forms 1042 and 1042-S.

These rules are now final

One takeaway from these revised regulations – and perhaps the most definitive – is that these rules and the obligations they implement are now final. Therefore, whether or not there is finality with respect to all aspects of this new information reporting regime, impacted organizations should begin – or in some cases continue – a path towards compliance.

Given the length and complexity of the final regulations, it will take some time to thoroughly assess their impacts and changes, but it is clear that FATCA will be a hot topic for many affected institutions and professionals as the analysis of the final regulations continues and additional guidance is issued.

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Endnotes

1 The GIIN replaces the FFI-EIN and FATCA ID introduced in the proposed regulations and other guidance.

2 Pre-FATCA Form W-8 means a version of a Form W-8, including a valid substitute form, that was issued prior to 2013 and that does not contain chapter 4 statuses.

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