

## Aim For Strict FATCA Compliance Despite Transition Period



*Law360, New York (June 02, 2014, 12:19 PM ET)* -- Compliance with new provisions that have become commonly referred to as the Foreign Account Tax Compliance Act, or "FATCA," recently became a little less daunting. On May 2, 2014, the Department of the Treasury and the Internal Revenue Service released Notice 2014-33, announcing that calendar years 2014 and 2015 will be regarded as a "transition period" for purposes of implementation of FATCA.

During this transitional period, the IRS will take into account the extent to which "good-faith efforts" were made to comply with FATCA. The notice further announced the intention of the Treasury and the IRS to relax the conditions to qualify as a "limited foreign FFI" or "limited branch," as well as the application of certain withholding and diligence rules, including the expansion of the rules regarding "preexisting obligations."

Taxpayers may rely on the provisions of the notice until the issuance of revised regulations incorporating its changes. These announcements have been positively received by stakeholders even though the changes fall short of an outright delay in FATCA implementation.

### Background

FATCA was enacted in March 2010 to address perceived tax abuse by U.S. persons using offshore accounts. Generally, FATCA provides that a foreign financial institution (FFI) will be subject to a 30 percent withholding tax on payments to it of U.S. source dividends, interest and other passive-type income, and gross proceeds from the sale or other disposition of any property that produces U.S. source interest or dividends ("withholdable payments"), unless the FFI enters into an agreement with the IRS under which it agrees to comply with certain reporting, due diligence and withholding requirements with respect to its U.S. accounts.

FATCA withholding will be phased in beginning on July 1, 2014. In order to help eliminate potential conflicts between FATCA and the legal requirements to which FFIs are subject in other countries, as well as to increase the efficiency of FATCA reporting, the United States has entered into intergovernmental

agreements (IGAs) with certain partner jurisdictions.

To be compliant with FATCA, FFIs generally must register with the IRS and obtain a Global Intermediary Identification Number. This GIIN will be used by FFIs to identify themselves as compliant with FATCA, and payors generally will be required to cross-check a payee FFI's GIIN to confirm FATCA compliance before making a withholdable payment to that payee.

### **Transitional period**

The notice announced that calendar years 2014 and 2015 will be regarded as a "transition period" for purposes of implementation of FATCA. During the transition period, the IRS will take into account the extent to which an FFI, direct reporting NFFE, sponsoring entity, sponsored direct reporting NFFE, or withholding agent has made "good-faith efforts" to comply with the requirements of the FATCA regulations and the temporary coordination regulations released on Feb. 20, 2014 (the "temporary coordination regulations").

Precisely what good-faith efforts entail is unclear. Unsurprisingly, an entity that has not made good-faith efforts to comply with FATCA will not be given any relief from IRS enforcement during the transition period, nor will any relief be granted for the requirements of Chapters 3 and 61, and Section 3406 of the Internal Revenue Code that were not modified by the temporary coordination regulations.

To satisfy the good-faith standard, absent further guidance to the contrary, FFIs should still strive for strict FATCA compliance. Thus, while the transitional period has been welcomed by stakeholders, FFIs should continue to plan on full FATCA compliance for the 2014 and 2015 calendar years.

### **Preexisting Obligations**

Existing FATCA regulations generally treat accounts, contracts, and debt or equity interests that are issued or otherwise executed prior to July 1, 2014, as "preexisting obligations," which are subject to less onerous diligence, withholding and reporting requirements than those issued on or after July 1, 2014.

The notice announced that the FATCA regulations will be amended so as to allow a withholding agent or FFI to treat an obligation that is held by an entity and that is issued, opened or executed on or after July 1, 2014, and before Jan. 1, 2015, as a "preexisting obligation" for purposes of the applicable FATCA diligence, withholding and reporting requirements.

Treasury will also update in a similar fashion the applicable rules and procedures outlined in the IGAs. These revised preexisting obligations rules will not apply to obligations held by individuals because the procedures for documenting individual accounts are less complex and the forms and instructions were already published in final form on March 3, 2014, for documenting individual accounts (i.e., Form W-9, Form W-8BEN and related instructions).

The changes announced in the notice are a welcome development in light of the fact that the IRS Form

W-8BEN-E (the form used by entities to certify their FATCA status) was only released on March 29, 2014, and instructions for that form have yet to be released.

Without instructions, many account holders and payees have been reluctant to execute the form. As a result of the expansion of “preexisting obligations”, a withholding agent or FFI generally will have more time to receive Forms W-8BEN-E or otherwise document an entity that is a payee or account holder of an obligation issued after July 1, 2014, and before Jan. 1, 2015. The expansion of “preexisting obligations” is particularly helpful for FFIs that have yet to register to receive a GIIN, as payors generally will not be required to withhold on payee FFIs until Jan. 1, 2015 (at the earliest).

### **Reason-to-Know Standards**

The temporary coordination regulations provide that a withholding agent will have reason to know that documentation establishing the foreign status of a direct account holder is unreliable or incorrect if the withholding agent has a current telephone number for the account holder in the United States and no telephone number for the account holder outside the United States, or has a U.S. place of birth for the account holder.

Those regulations also provide a transitional rule, however, to allow a withholding agent that has previously documented the foreign status of a direct account holder for purposes of Chapters 3 and 61 of the Internal Revenue Code prior to July 1, 2014, to continue to rely on such documentation (without regard to whether the withholding agent has a U.S. telephone number or U.S. place of birth for the account holder).

This transitional rule was of limited use for withholding agents because it is tied to a withholding agent's reliance on documentation obtained from an account holder prior to July 1, 2014, and may therefore not have applied in cases where the withholding agent was required to renew withholding certificates or documentary evidence after that date.

The notice fixed this by providing that a withholding agent that has documented a direct account holder prior to July 1, 2014, is not required to apply the reason-to-know standards relating to a U.S. telephone number or U.S. place of birth (i.e., the account holder will continue to be considered documented prior to July 1, 2014, for this purpose even if required renewal documentation has been provided after that date) until the withholding agent is notified of a change in circumstances with respect to the account holder's foreign status or reviews documentation (other than that renewal documentation) for the account holder that contains a U.S. place of birth.

### **Claims of Foreign Status**

The FATCA final regulations and the temporary coordination regulations each provide that a withholding agent may rely on the foreign status of an individual account holder irrespective of certain U.S. indicia if, in certain cases, the account holder provides a reasonable explanation supporting the account holder's claim of foreign status. However, the temporary coordination regulations contain a slightly less

restrictive standard for what constitutes a reasonable explanation for this purpose. The notice makes clear that the FATCA final regulations will be modified to conform to the temporary coordination regulations in this regard.

### **Limited FFIs and Limited Branches**

Generally, for any member of an expanded affiliated group to obtain status as a participating FFI or registered deemed-compliant FFI, each FFI in the member's expanded affiliated group must comply with FATCA. However, before Jan. 1, 2016, a participating FFI or registered deemed-compliant FFI is permitted to have certain entities or branches that are not able to fully satisfy the requirements of the FFI agreement so long as they are treated as a "limited branch" or "limited FFI."

One of the requirements to obtain this limited status is that the FFI or branch of a participating FFI must be registered with the IRS and agree to certain conditions, including that the FFI or branch not open accounts that it would be required to treat as U.S. accounts or accounts held by nonparticipating FFIs, including accounts transferred from any member of its expanded affiliated group.

Consistent with the model IGAs, the notice announces that the FATCA regulations will be modified to permit a limited FFI or limited branch to open U.S. accounts for persons resident in the jurisdiction where the limited FFI or limited branch is located, and accounts for nonparticipating FFIs that are resident in that jurisdiction, provided that the limited FFI or limited branch does not solicit U.S. accounts from persons not resident in, or accounts held by nonparticipating FFIs that are not established in, such jurisdiction and the limited FFI or limited branch is not used by another FFI in its expanded affiliated group to circumvent the obligations of such other FFI under FATCA.

Furthermore, the notice states that the final FATCA regulations will be amended to provide that if an FFI is prohibited under local law from registering as a limited FFI, the prohibition will not prevent the members of its expanded affiliated group from obtaining status as participating FFIs or registered deemed-compliant FFIs. Instead, the FFI in the foreign jurisdiction with the prohibition must be identified as a limited FFI on the FATCA registration website by a member of the expanded affiliated group that is a U.S. financial institution or an FFI seeking status as a participating FFI (including a reporting Model 2 FFI) or reporting Model 1 FFI.

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