FATCA Certifications and Notice 2016-08

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In January 2016, the IRS issued Notice 2016-08, which, most importantly, delayed the timing for participating foreign financial institutions and compliant foreign financial institutions located in Model 2 IGA jurisdictions to certify as to their FATCA compliance. The authors address the importance of these FATCA certifications, why these certifications were modified, and the Notice's impact on the timing of the certification. In addition, they describe and explain several other clarifications to the FATCA regulations made in the Notice.

On January 19, 2016, the U.S. Internal Revenue Service (IRS) issued additional guidance relating to chapter 4 of Subtitle A of the Internal Revenue Code (commonly referred to as FATCA).[2] This guidance, Notice 2016-08 (the "Notice"), announced the intention of the U.S. Department of Treasury ("Treasury") and the IRS to amend certain Treasury regulations promulgated under FATCA. Most notably, the Notice has the effect of delaying the date on which certain certifications made by participating foreign financial institutions ("participating FFIs") and compliant (or "reporting") foreign financial institutions located in Model 2 IGA jurisdictions ("Model 2 FFIs"), which would otherwise have been due August 29, 2016. This article will address the importance of these FATCA certifications, why the "preexisting account" certification was modified, and the Notice's impact on the timing of the certification. In addition, it describes and explains several other clarifications to the FATCA regulations that are contained in the Notice, including provisions that would (1) eliminate gross proceeds reporting with respect to payments made by participating FFIs, Model 2 FFIs, and certain registered deemed-compliant FFIs to nonparticipating foreign financial institutions (NPFFIs) during the 2015 calendar year, and (2) modify certain rules permitting the reliance on electronically furnished Forms W-8 and W-9 provided by an intermediary.

Basic FATCA Background

On March 18, 2010, the Hiring Incentives to Restore Employment Act of 2010[3] added FATCA to the Code, as Sections 1471 through 1474. Treasury and the IRS published final regulations under FATCA on January 28, 2013, and a few months later, on September 10, 2013, published corrections to those final regulations (hereinafter, collectively, the "FATCA regulations").[4] These provisions generally require withholding agents (i.e., payors of applicable income) to withhold 30 percent on certain payments made to an FFI unless (1) the FFI has entered into an agreement with the IRS ("FFI agreement") to obtain status as a participating FFI and to, among other things, report certain information with respect to U.S.

accounts; or (2) the FFI is deemed to comply with FATCA and not obligated to execute an FFI Agreement, either by reference to having complied with certain provisions in the FATCA regulations or Annex 2 of an applicable FATCA Intergovernmental Agreement (IGA) or by being considered a reporting Model 1 FFI (i.e., an FFI that is located within a jurisdiction with a Model 1 IGA and such FF1 is considered a reporting Model 1 FFI pursuant to such agreement).

The amounts subject to withholding under FATCA are "withholdable payments," which includes any payment of U.S.-source fixed or determinable annual or periodical (FDAP) income, such as interest and dividends, and, outside of an applicable IGA, for sales or other dispositions occurring after December 31, 2018, any gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends that are U.S.-source income.[5] Withholding on withholdable payments of U.S.-source FDAP income generally began on July 1, 2014. (The transitional rule that provides for gross proceeds withholding after December 31, 2018, allows FFIs and withholding agents to implement FATCA in stages to minimize burdens consistent with ensuring that the information reporting objectives of FATCA are met and maintained.)

In addition to withholding on "withholdable payments," in order for an FFI, other than a Model 2 FFI, to fully comply with its FFI agreement, it must also withhold on passthru payments made to recalcitrant account holders (i.e., those account holders that fail to comply with information requests) and NPFFIs.[6] A passthru payment is defined in the regulations to mean a withholdable payment and any foreign passthru payment. The FATCA regulations reserve on the definition of the term "foreign passthru payment."[7] In the meantime, a transitional rule provides that a participating FFI is not required to withhold tax on a foreign passthru payment made to a recalcitrant account holder or a NPFFI before the later of January 1, 2019, or the date of publication in the Federal Register of final regulations defining foreign passthru payment.[8] FATCA also imposes on withholding agents certain withholding, documentation, and reporting requirements with respect to certain payments made to certain non-financial foreign entities.

During 2012, Treasury first released Model 1 and Model 2 IGAs to facilitate the implementation of FATCA and to avoid legal impediments under local law that would otherwise limit an FFI's ability to comply with the requirements under FATCA. As guidance was originally published, jurisdictions were supposed to enter into IGAs with the United States by early 2014 in order to avail their local FFIs of the benefits of such IGAs. However, the public expressed concerns that FFIs located in jurisdictions that are expected to sign an IGA, but have not yet signed the agreement, are unable to plan effectively and efficiently for FATCA given the uncertainty regarding when the relevant IGA may be signed and therefore is treated as being in effect. Therefore, Treasury and the IRS subsequently published guidance providing that the jurisdictions treated as having an IGA in effect would include jurisdictions that have reached agreements in substance with the United States on the terms of an IGA and that have consented to be included on the Treasury and IRS lists of such jurisdictions, in addition to jurisdictions that have already signed IGAs. An FFI that is resident in, or organized under the laws of, a jurisdiction that is included on the Treasury and IRS lists as having an IGA in effect is permitted to register on the FATCA registration website and is permitted to certify to a withholding agent its status as an FFI covered by an IGA. As of April 1, 2016, Treasury had either signed IGAs or had agreements in substance with 112 jurisdictions.

Importance Of FATCA Certifications

Prior to addressing the details of the Notice, it is worthwhile to discuss what may be, perhaps, the most important aspect of FATCA—the certifications of compliance to the IRS. When people think of FATCA, three subjects immediately come to mind—due diligence, withholding, and reporting. Many think of FATCA as a withholding regime, similar to nonresident alien withholding under chapter 3 of Subtitle A to the Code. While FATCA does contain a withholding tax component, it would be a mistake to simply view FATCA as another withholding tax regime. Practically speaking, withholding may not be an issue for many global FFIs, either because they are located in a Model 1 IGA jurisdiction, which does not require an FFI to withhold,[9] or because many accountholders are FATCA compliant (i.e., not subject to withholding). The FATCA withholding tax is merely a tool to facilitate its true purposes information reporting and, to a lesser extent, exchange of information with other jurisdictions.

As an information reporting regime, FATCA's effectiveness will be determined by reference to how well FFIs comply with their obligations to (1) conduct due diligence with respect to their account holders and (2) report such information to applicable authorities. FATCA due diligence processes are intended to ascertain whether a U.S. person is a direct or indirect account holder of an account maintained at such FFI and to ascertain whether account holders that are financial institutions have not agreed to undertake the requisite due diligence (i.e., that the financial institution is an NPFFI). While the details and complexities of FATCA due diligence are beyond the scope of this article, it is sufficient to note that the rigor of these procedures reflects FATCA's primary goal: to identify U.S. persons who maintain accounts outside the United States in order to ensure that income from such accounts does not escape taxation. Thus, to the extent that these due diligence procedures are appropriately fulfilled, U.S. persons should be identified and information about their accounts reported to the IRS. On the other hand, any failure to comply with the applicable FATCA due diligence procedures may result in a U.S. person inappropriately avoiding U.S. tax. Policing this critical due diligence function is likely to be difficult for the IRS, particularly during the implementation phase. Accordingly, it is not surprising that the IRS imposed a self-certification regime in its FFI Agreement, thereby causing participating FFIs and Model 2 FFIs to be obligated to undertake certain internal reviews in order to certify their compliance with FATCA to the IRS.

To ensure that FFIs are, in fact, complying with the appropriate diligence and reporting procedures, FATCA requires that FFIs provide three specific certifications to the IRS:

1. An FFI must certify that the FFI has complied with the due diligence procedures for preexisting accounts (i.e., those individual accounts opened prior to July 1, 2014, and entity accounts opened prior to January 1, 2015) within the applicable time-frame (the "preexisting account certification");[10]
2. An FFI must certify that the FFI did not have practices and procedures to assist account holders in the avoidance of FATCA;[11] and
3. An FFI must provide a periodic certification to the IRS that the FFI has complied with the terms of its FFI agreement.[12]

The first and second of these certifications are designed to provide comfort that the FFI has appropriately complied with the due diligence procedures and documented accounts appropriately, and generally apply to preexisting accounts. The third and final certification generally relates to overall compliance with the terms of the FFI agreement and does not solely relate to due diligence matters.

The first certification requires a "responsible officer" to certify that the FFI has completed the applicable review of all preexisting "high-value" accounts and treated any account holder of an account for which the FFI has not retained a record of required documentation as a recalcitrant account holder. (A "responsible officer" is someone appointed by the FFI to oversee the FFI's compliance with the requirements of FATCA via its FFI agreement. The responsible officer must (either personally or through designated persons) establish a compliance program that includes policies, procedures, and processes sufficient for the FFI to satisfy the requirements of the FFI agreement.) The responsible officer must also certify that the FFI has completed the account identification procedures and documentation requirements for all other preexisting accounts or, if it has not retained a record of the documentation with respect to an account, treated such account as recalcitrant or applied the presumption rules, as applicable.

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The second certification requires a responsible officer to certify, to the best of its knowledge after conducting a reasonable inquiry, that the FFI did not have any formal or informal practices or procedures in place from August 6, 2011, through the date of such certification to assist account holders in the avoidance of FATCA. A reasonable inquiry for these purposes is a review of the FFI's procedures and a written inquiry (e.g., e-mail requests to relevant lines of business) that requires responses from relevant customer on-boarding and management personnel as to whether they engaged in any such practices during that period. Practices or procedures that assist account holders in the avoidance of FATCA include, for example, suggesting that account holders split up accounts to avoid classification as a high-value account; suggesting that account holders of U.S. accounts close, transfer, or withdraw from their account to avoid reporting; intentional failures to disclose a known U.S. account; suggesting that an account holder remove U.S. indicia from its account information; or facilitating the manipulation of account balances or values to avoid thresholds.

The third certification is an on-going, periodic certification that requires a responsible officer to either certify that the FFI maintains effective internal controls or, if the FFI has failed to remediate any "material failures" as of the date of the certification, the responsible officer must make a qualified certification.

Due to the development of the IGA approach to FATCA, as explained below, compliance has, in part, been delegated from the IRS to local authorities. The IRS has clear authority to direct the manner and means by which participating FFIs (including Model 2 FFIs) comply with FATCA because such FFIs are obligated to enter into an FFI Agreement with the IRS. Accordingly, those entities resident in jurisdictions that have not signed an IGA with the United States and Model 2 FFIs (since Model 2 IGA jurisdictions require their FFIs to enter into an FFI agreement with the IRS) are subject to these certifications (via their respective FFI agreements). That being said, entities that are not obligated to enter into an FFI Agreement, such as certain deemed-compliant FFIs and Model 1 FFIs, are not obligated to provide these certifications. As a general matter, a Model 1 FFI's compliance with FATCA is initially governed by local tax authorities, and not the IRS, although the IRS could assert that the Model 1 FFI is not in compliance with the terms of the relevant IGA. In practice, it is unclear how the IRS would generally be in a position to properly ascertain whether a Model 1 FFI is not

in compliance with local requirements and/or the relevant IGA.[13]

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Given the importance of the accuracy of the due diligence process, FATCA certifications are vital to an FFI's compliance. Since the enactment of FATCA and the publication of the FATCA regulations, FFIs have spent time focusing on diligence; withholding, to the extent necessary; and reporting, as applicable. Prior to the issuance of the Notice, many FFIs had not yet either focused on undertaking the review necessary to provide the requisite certifications or completed the due diligence obligations that are a prerequisite to providing any such certification. Fortunately, the Notice delayed the first two mentioned certifications (which were originally due by August 29, 2016) to 2018, such that all three certifications are now required at the same time.

Harmonization of FATCA Certification Timing

As described above, participating FFIs and Model 2 FFIs are required to comply with the preexisting account certification[14] and must also periodically certify to the IRS that they have complied with the terms of the FFI agreement ("periodic certification of compliance").[15]

The preexisting account certification was required to be made no later than 60 days following the date that is two years after the effective date of the FFI agreement. Thus, a participating FFI or Model 2 FFI that has an FFI agreement with an effective date of June 30, 2014, would have been required to submit a preexisting account certification to the IRS by August 29, 2016. The periodic certification of compliance must be submitted to the IRS no later than six months following the end of the certification period:[16] The first certification period begins on the effective date of the FFI agreement and ends at the close of the third full calendar year following the effective date of the FFI agreement. Each subsequent certification period is every three calendar years following the previous certification period. Thus, under the FFI agreement, if a participating FFI or Model 2 FFI has an FFI agreement with an effective date of June 30, 2014, the first certification period for the FFI ends on December 31, 2017, and the FFI's first periodic certification of compliance must be made on or before July 1, 2018.

The Notice delayed the date on which the preexisting account certification would be due. Consequently, the preexisting account certification will be due at the same time as when a participating FFI or Model 2 FFI is required to provide its first periodic certification to the IRS that it has complied with the terms of the FFI agreement. Thus, a participating FFI or Model 2 FFI that has an FFI agreement with an effective date of June 30, 2014, will be required to initially submit all certifications to the IRS by July 1, 2018. (The Notice was subsequently amended to clarify that the preexisting account certification includes the participating FFI's or Model 2 FFI's certification that it didn't have practices and procedures to assist account holders in the avoidance of FATCA. As originally published, it was not clear whether such certification benefited from the Notice's delay.)

It is important to note that, while the Notice extends the preexisting account certification period, it does not affect the deadlines for a participating FFI or Model 2 FFI to complete the actual due diligence procedures for preexisting accounts. FFIs are still required to certify to having completed the due diligence procedures within the required time frame.

It is not only participating FFIs and Model 2 FFIs that must make certifications to the IRS. A registered deemed-compliant FFI that is a local FFI or restricted fund is required to make a one-

time certification regarding its preexisting accounts similar to the certification requirement of a participating FFI.[17] Restricted funds must make this certification by the later of December 31, 2014, or six months after the date the FFI registers as a registered deemed-compliant FFI. The FATCA regulations do not specify a time for local FFIs to make this certification. Each registered deemed-compliant FFI additionally must certify every three years to the IRS that all of the requirements for the deemed-compliant category claimed by the FFI have been satisfied since the later of the date the FFI registered as a registered deemed-compliant FFI or June 30, 2014 ("periodic certification of registered deemed-compliant status").[18] Similarly, the FATCA regulations do not specify a time for submitting the periodic certification of registered deemed-compliant status or the date on which the first certification period begins.

The Notice provides that the FATCA regulations will be amended to provide that:

1. Local FFIs and restricted funds must submit their one-time certifications regarding preexisting accounts at the same time that they submit the first periodic certification of registered deemed-compliant FFI status;
2. Registered deemed-compliant FF1s must provide the periodic certification of registered deemed-compliant FFI status on or before July 1 of the calendar year following the end of the certification period; and
3. The first certification period begins on the later of the date the FFI registered as a deemed-compliant FFI or June 30, 2014, and ends at the close of the third full calendar year following such date. (Subsequent certification periods will continue to be the three-calendar-year period following the previous certification period.)

Thus, a registered deemed-compliant FFI that is a local FFI and that has such status on June 30, 2014, will be required to make its one-time certification regarding preexisting accounts and its first periodic certification of registered deemed-compliant FFI status on or before July 1, 2018.

While the Notice extends the preexisting account certification period, it does not affect the deadlines for a participating FFI or Model 2 FFI to complete the actual due diligence procedures for preexisting accounts. FFIs are still required to certify to having completed the due diligence procedures within the required time frame.

The Notice also corrected an inconsistency between the FATCA regulations and the FFI agreement. The FATCA regulations will be amended to specify that the periodic certification of compliance must be submitted on or before July 1 of the calendar year following the certification period (instead of no later than six months following the end of the certification period).

Elimination of Gross Proceeds Reporting For Payments To Npffis During The 2015 Calendar Year

Prior to the issuance of the Notice, a participating FFI or Model 2 FFI that maintains an account of a NPFFI (including a limited branch and limited FFI treated as a NPFFI) had to provide transitional reporting to the IRS of all foreign reportable amounts paid (i.e., foreign-source payments, including gross proceeds) to or with respect to the account for calendar years 2015 and 2016.[19] Alternatively, a participating FFI or Model 2 FFI could report all income, gross proceeds, and redemptions paid to or with respect to an account held by a NPFFI, instead of reporting only foreign reportable amounts.[20] In contrast, participating FFIs and Model 2 FFIs would not be required to report gross proceeds

paid to U.S. accounts and accounts held by owner-documented FFIs for calendar year 2015.

In response to the public comments on the burdens of requiring gross proceeds reporting for accounts held by NPFFIs in advance of when such amounts have to be reported for a U.S. account or account of an owner-documented FFI, and given that the transitional reporting for accounts of NPFFIs was not intended, according to the IRS, to require more information to be reported than would be required for U.S. accounts or accounts held by owner-documented FFIs, the Notice eliminated gross proceeds reporting with respect to amounts paid by participating FFIs, Model 2 FFIs, and certain registered deemed-compliant FFIs to an NPFFI for calendar year 2015, such that reporting with respect to NPFFIs occurs in the same manner as reporting to U.S. accounts and accounts held by owner-documented FFIs.

For calendar year 2015, such that reporting with respect to NPFFIs occurs in the same manner as reporting to U.S. accounts and accounts held by owner-documented FFIs.

Note: This rule applies to certain registered deemed-compliant FFIs; in practice, this is likely limited to sponsored registered deemed-compliant FFIs. The other registered deemed-compliant FFIs, i.e., local FFIs, nonreporting members of participating FFI groups, restricted funds, and qualified collective investment vehicles, either have a prohibition against NPFFI account holders (e.g., qualified collective investment vehicles) or must transfer or close an account held by an NPFFI (e.g., nonreporting members of a participating FFI group). Technically, there is no prohibition against a credit card issuer maintaining an account for an NPFFI, but this type of reporting concern is unlikely to arise in the credit card context. For registered deemed-compliant FFIs that must close or transfer an account of an NPFFI, it is unclear to what extent, if any, this Notice applies to the extent that an NPFFI account exists for a portion of the year.

Electronically Furnished Forms W-8 and W-9

Treasury regulations and related IRS guidance permit a withholding agent to establish a system for a beneficial owner or payee to electronically furnish a Form W-8 (including a substitute Form W-8), and provide requirements for such a system.[21] These electronic system rules require, among other things, that the Form W-8 be signed electronically and under penalties of perjury by the person whose name is on the Form W-8. An electronic system that satisfies these rules permits a withholding agent to accept the electronic version of the Form W-8 as an original. There are similar standards for purposes of establishing an electronic system for the Form W-9.[22]

A foreign intermediary or flow-through entity that has not entered into a qualified intermediary, foreign withholding partnership, or foreign withholding trust agreement is a nonqualified intermediary (NQI), nonwithholding foreign partnership (NWP), or nonwithholding foreign trust (NWT). An NQI, NWP, or NWT that receives a payment on behalf of its account holders, partners, owners, or beneficiaries is required to provide documentation to its withholding agent so that the withholding agent may reliably associate the payment (or portion of the payment) with valid documentation upon which it may rely to determine its requirement to withhold. A withholding agent that receives documentation for a payee or beneficial owner through an NQI, NWP, or NWT (including a U.S. branch or territory financial institution, other than a U.S. branch or territory financial institution that is treated as a U.S. person) may rely on such documentation unless the withholding agent knows that the documentation is unreliable or

incorrect pursuant to the applicable standards of knowledge.

Public commentators have requested that these Treasury regulations specify that a withholding agent may rely on a Form W-8 or W-9 for a beneficial owner or payee that has been indirectly obtained by the withholding agent through an NQI, NWP, or NWT, irrespective of whether the NQI, NWP, or NWT collects the underlying Form W-8 or W-9 through an electronic system. The comments have noted that, in the absence of such guidance, current industry practice is for withholding agents to reject these forms because they cannot confirm the authenticity of the electronic signature. As a result, the payee or beneficial owner may be subject to withholding or backup withholding based on an applicable presumption rule.

The Notice clarified that Treasury and the IRS intend to amend Treasury regulations so that a withholding agent may rely on a Form W-8 or W-9 that has been collected from the beneficial owner or payee of the payment through an electronic system maintained by an NQI, NWP, or NWT and furnished to the withholding agent by such NQI, NWP, or NWT. However, the withholding agent may rely on such form provided that the NQI, NWP, or NWT is a direct or indirect account holder of the withholding agent and the withholding agent obtains from the NQI, NWP, or NWT a written statement confirming that the electronic documentation was generated from a system that meets the applicable requirements, and the withholding agent does not have actual knowledge that such statement is incorrect.

Unaddressed Items

Although the Notice addressed a number of stakeholder concerns, certain noteworthy issues remain. For instance, while the Notice provided additional guidance regarding the date on which the preexisting account certification is due, it did not provide any additional guidance regarding the substance of this certification or the process by which a responsible officer undertakes the review necessary to make the certification. Additionally, the Notice addressed only the certification obligations of participating FFIs and Model 2 FFIs; it is silent regarding the FATCA-related QI certifications applicable to a QI located in a Model 1 jurisdiction. Given the importance of these certifications with respect to a participating FFI and Model 2 FFI, it seems reasonable to assume that Treasury and the IRS will address these items in future guidance.

Treasury and the IRS intend to amend Treasury regulations so that a withholding agent may rely on a Form W-8 or W-9 that has been collected from the beneficial owner or payee of the payment through an electronic system maintained by an NQI, NWP, or NWT.

Endnotes

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[2] Unless specifically stated otherwise, references to Sections herein are to the Internal Revenue Code of 1986, as amended (the "Code" or IRC) or the regulations thereunder.

[3] P.L. 111-147 (H.R. 2847).

[4] 78 Fed. Reg. 5874; corrected in 78 Fed. Reg. 55202.

[5] IRC § 1473(1)(A); Treas. Reg. § 1.1473-1(a), modified by Notice 2015-66.

[6] See IRC § 1471 (b)(1)(D)(i).

[7] Treas. Reg. § 1.1471-5(h)(2). Previously proposed regulations associated a passthru payment with the amount of U.S. accounts held by an FFI. However this definition was removed from the current version of the regulations.

[8] Treas. Reg. § 1.1471-4(b)(4), modified by Notice 2015-66.

[9] Unless the FFI is also a "qualified intermediary" (QI) that has assumed primary withholding responsibility.

[10] Treas. Reg. § 1.1471-4(c)(7) and Section 8.03(A) of the FR agreement.

[11] Id.

[12] Treas. Reg. § 1.1471-4(f) and Section 8.03 of the FFI agreement.

[13] The IRS has asserted jurisdiction over Model 1 FFIs that are also QIs though the terms of those entities' QI Agreements.

[14] Treas. Reg. § I.1471-4(c)(7) and Section 8.03(A) of the HI agreement.

[15] Treas. Reg. § 1.1471-4(f)(3) and Section 8.03 of the FFI agreement.

[16] See Treas. Reg. S M471-4(0(3)0). Notwithstanding the regulations, Section 8.03 of the FFI agreement allows the periodic certification of compliance to be submitted on or before July 1 of the calendar year following the certification period.

[17] Treas. Reg. §§ 1.1471-5(1)(1)(0(A)(7) and 1.1471-5(f)(1)(i)(D)(6).

[18] Treas. Reg. § 1.1471-5(f)(1)(ii)(B).

[19] Treas. Reg. § 1.1471-4(d)(2)(ii)(F) and Section 6.04 of the FFI agreement.

[20] Id.

[21] IRC §§ 1.1441-1(e)(4)(iv) and 1.1471-3(c)(6)(iv).

[22] Announcement 98-27 (1998-1 C.B. 865).