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The IRS Issues Final FATCA Regulations

On January 17, 2013, the Internal Revenue Service (IRS) released 544 pages of final regulations implementing the provisions of the Foreign Account Tax Compliance Act (FATCA). The FATCA provisions of the Internal Revenue Code require non-U.S. financial institutions and investment entities to conduct due diligence on their account holders, broadly defined, and report on U.S. persons who hold accounts with such companies to the IRS. The final regulations differ dramatically from the proposed regulations issued in February 2012.

I. A Brief Background for the Newly-Initiated

The FATCA rules were added to the Internal Revenue Code of 1986, as amended (the "Code") in March 2010 by the Hiring Incentives to Restore Employment Act of 2010.[1] These provisions, contained in Code §§ 1471 through 1474, contain an extraordinary set of penalty tax rules on foreign financial institutions (FFIs) that do not (i) conduct due diligence on their account holders, equity holders and debt holders to ferret out U.S. persons that are holding assets outside of the United States and (ii) disclose the identity of such persons to the IRS.[2] Specifically, if the FFI does not comply with the FATCA rules, then "withholdable payments" to it for its own account and on behalf of its customers are subject to U.S. federal income tax withholding.[3] Withholdable payments include items of U.S.-source income, such as interest and dividends, as well as gross proceeds "from the disposition of any property of a type which produce interest or dividends from sources within the United States."[4] If the payment is made for the account of a non-participating FFI, "no credit or refund shall be allowed or paid with respect to such tax."[5] In other words, if an FFI does not comply with the FATCA rules, it will be subjected to gross proceeds withholding on its U.S.-source income and will not be able to recover the withheld amounts.

Code § 1471(b) contains the six requirements that must be met in order for an FFI to be considered to be in compliance with the FATCA rules:

1. The FFI must obtain the information necessary to determine if it has "United States accounts."
2. The FFI must comply with IRS-specified due diligence and verification requirements with respect to U.S. accounts.
3. The FFI must annually report IRS-specified information to the IRS on its U.S. accounts.
4. 4. The FFI must withhold on U.S.-source payments made to recalcitrant account holders6 and non-compliant FFIs and withhold on payments to other FFIs who have elected not to withhold on their own recalcitrant account holders.
5. The FFI must comply with IRS requests for additional information.
6. The FFI must attempt to obtain a waiver of any foreign law that would prevent the transmission of the information sought by the IRS to the IRS on the FFI's accounts

and, if such waiver cannot be obtained, to close the affected accounts.

Prior to the release of the final FATCA regulations, the IRS has released proposed regulations,[7] and four public administrative releases: (i) Notice 2010-60,[8] (ii) Notice 2011-34,[9] (iii) Notice 2011-53[10] and (iv) Announcement 2012-42.[11] Notice 2010-60 delineated when certain foreign entities would be treated as FFIs and prescribed certain due diligence rules that FFIs would be required to complete in order to satisfy their due diligence requirements on account holders. Notice 2011-34 modified and expanded such due diligence requirements and provided guidance on the passthru payment rules. Notice 2011-53 extended the period of time that FFIs would have before FATCA withholding requirements became effective. Announcement 2012-42 revised the timeline for FATCA compliance and presaged certain changes to such timeline that are now contained in the final FATCA regulations.

II. FATCA Deadlines, Effective Dates and Grandfathering Rules

The effective dates for FATCA compliance have been a moving target because the IRS revised such timeline on several occasions to reflect comments from affected persons about the scope of the actions required by a particular date. In addition, the timeline for due diligence and reporting for FFIs subject to Intergovernmental Agreements (IGAs) did not appear to be coordinated with the timeline for such responsibilities for FFIs governed by the FATCA provisions contained in the Code.

A. PFFI Reporting for 2013. FFIs that elect to comply with the FATCA due diligence and withholding regime (referred to as "Participating FFIs" or PFFIs) must enter into an FFI Agreement with the IRS. The final FATCA regulations delay the effective date for all pre-2014 FFI Agreements until December 31, 2013. This change aligns the effective date of, and due diligence periods under, the FFI agreement with the timelines provided under the IGAs.

A PFFI must report on all accounts that are identified and documented as U.S. accounts or accounts held by owner-documented FFIs as of December 31, 2014, (or as of the date an account is closed if the account is closed prior to December 31, 2014) if such account was outstanding on December 31, 2013. The final regulations incorporate the reporting requirements in Announcement 2012-42 with respect to calendar year 2013. The reporting for U.S. accounts that are maintained by a PFFI during 2013 is made under streamlined reporting rules. The final regulations also move back the reporting 2013 accounts from September 30, 2014 to March 31, 2015.

B. CIV and Restricted Fund Grandfathering. For FATCA purposes, collective investment vehicles (CIVs) include investment entities that are registered as such or whose managers are regulated as a manager in the country in which the investment fund is registered.[12] A Restricted Fund is an investment entity regulated in a country which is compliant with the Financial Action Task Force (FATF) anti-money laundering policies. [13] CIVs and Restricted Funds can qualify as "deemed compliant FFIs." A deemed compliant FFI is automatically considered to meet the 6 requirements specified above to be FATCA compliant.[14] The final regulations permit qualified CIVs and Restricted Funds to have outstanding bearer obligations that were issued prior to January 1, 2013, if the qualified CIV or Restricted Fund identifies the status of the holder prior to payment, no shares are issued in bearer form, including reissuances of surrendered shares, after December 31, 2012, and certain other conditions are met. All bearer instruments must be "immobilized" or redeemed prior to January 1, 2017.[15]

C. Restricted Fund Distribution Agreements. In order for a Restricted Fund to qualify as a deemed compliant FFI, interests in

the Fund must not be sold to specified U.S. persons, non-participating FFIs (NPFFIs) or passive NFFEs with one or more substantial U.S. owners.[16] The IRS, in recognition that renegotiation of distribution agreements will take a substantial amount of time, provided investment funds until the later of June 30, 2014, or six months after the date the investment fund registers with the IRS as a registered deemed-compliant FFI to renegotiate its debt and equity interest distribution agreements to comply with this rule. The Treasury Department and the IRS also modified the sales restrictions to restrict sales only to specified U.S. persons, rather than all U.S. persons as was provided in the proposed regulations.

D. FATCA Withholding Generally. Subject to the exception for preexisting accounts, the final regulations provide that withholding agents can be required to withhold on payments to non-financial foreign entities (NFFEs) only with respect to payments made after December 31, 2013.[17] Similarly, except as otherwise provided in a Model 2 IGA, a PFFI is required to deduct and withhold a tax equal to 30% of any withholdable payment made to an account held by a recalcitrant account holder or to a NPFFI after December 31, 2013.[18] In addition, withholding agents are not required to withhold on payments made before January 1, 2015, with respect to a "preexisting obligation" to a payee that is not a prima facie FFI and for which a withholding agent does not have documentation indicating the payee's status as a passive NFFE with one or more substantial U.S. owners.[19] Importantly, the definition of pre-existing account has been amended by the final regulations to include "any account, instrument, contract, debt or equity interest . . . outstanding on December 31, 2013.[20]

The final FATCA regulations provide special rules that permit Model 1 IGA FFIs to provide certain information to a withholding agent to confirm their status and avoid FATCA withholding tax.

E. Prima Facie FFI Withholding. *Prima facie* FFIs include banks, brokerages, securities and commodities dealers and asset-backed securities.[21] If the payee is a prima facie FFI, the withholding agent must treat the payee as a NPFFI beginning on July 1, 2014 and begin withholding on payments, until the date the withholding agent obtains documentation sufficient to establish a different FATCA status of the payee.

F. Preexisting Accounts. For any withholdable payment made prior to January 1, 2016, with respect to a preexisting obligation held by an FFI for which a withholding agent does not have documentation indicating the payee's status as a NPFFI, the withholding agent is not required to withhold unless the payee is a *prima facie* FFI.[22] A preexisting obligation is a financial instrument that was held in account with the withholding agent on December 31, 2013. In addition, the final regulations allow participating FFIs and withholding agents until December 31, 2015, to document account holders and payees that are not *prima facie* FFIs.

In contrast to the rule for FFIs, withholding agents are not required to withhold on payments made before January 1, 2015 to a passive NFFE, with respect to a preexisting obligation and for which a withholding agent does not have documentation indicating the payee's status as a passive NFFE with one or more substantial U.S. owners.[23] A passive NFFE is an entity that is not an FFI, a publicly-traded corporation or an NFFE engaged in the conduct of an active business.[24]

G. Grandfathered Obligations. No FATCA withholding is required with respect to grandfathered obligations.[25] The final regulations provide that grandfathered obligations consist of: (1) any obligation outstanding on January 1, 2014; (2) any

obligation that produces withholdable payments solely because the obligation is treated as giving rise to a dividend equivalent pursuant to Code § 871(m) that is entered into on or before 6 months after the date on which transactions of its type are first treated as giving rise to dividend equivalents; and (3) any agreement requiring a secured party to make payments with respect to collateral securing one or more grandfathered obligations (even if the collateral is not itself a grandfathered obligation). If collateral (or a pool of collateral) secures both grandfathered obligations and obligations that are not grandfathered, the collateral posted to secure the grandfathered obligations must be determined by allocating (*pro rata* by value) the collateral to all outstanding obligations secured by the collateral. [26] For this purpose, an obligation does not include equity instruments, instruments without a stated term or a brokerage agreement.[27]

A grandfathered obligation will lose its grandfather status if it is materially modified.[28] Under the final FATCA provide that regulations a withholding agent is required to treat an obligation as being materially modified only if the withholding agent knows or has reason to know that a material modification has occurred with respect to the obligation. A withholding agent will be considered to have reason to know that a material modification has occurred with respect to an obligation if the withholding agent receives a disclosure from the issuer of the obligation stating that there has been a material modification to such obligation.[29]

H. Qualified Intermediaries (QIs). Beginning January 1, 2014, withholding QIs will be required to assume FATCA withholding and reporting responsibilities with respect to their accounts as a condition for maintaining QI status or for obtaining QI status. Existing QI agreements will be modified to take into account the applicable FATCA requirements. The modified provisions of the QI agreement will be set forth in a Revenue Procedure. Existing QIs will be required to renew their QI agreements by registering on the Portal and agreeing to comply with the modified QI agreement. Such a renewing QI will be issued a Global Intermediary Identification Number (GIIN) that it will use for FATCA reporting purposes and establishing its FATCA status with withholding agents. The GIIN will replace the current QI-EIN.

I. FFIs with Limited Branches. PFFIs with one or more "limited branches" will cease to be a PFFI after December 31, 2015, unless otherwise provided pursuant to an IGA.[30] A limited branch is a branch of an FFI that, under the laws of its jurisdiction as of February 15, 2012, cannot comply with FATCA, but with respect to which the FFI agrees to certain operating restrictions to prevent abuses of the FATCA withholding rules.

J. Gross Proceeds and (the much-dreaded) Pass-Thru Payment Withholding. Gross proceeds withholding, on sales or other dispositions of any property of a type that can produce interest or dividends that are U.S. source FDAP income, is required for any sales or other dispositions occurring after December 31, 2016.[31] Pass-thru payment withholding will not begin prior to the later of 2017 or 6 months after the date of publication in the Federal Register of final regulations defining the term foreign passthru payments.

K. Offshore Obligations. Offshore obligations are defined to mean accounts maintained at branches outside of the United States and also includes equity interests in entities that are purchased outside of the United States.[32] Withholding obligations on offshore obligations are limited on certain payments of U.S. source FDAP income made prior to January 1, 2017, with respect to offshore obligations.[33] Specifically, the exception is limited to payers not acting as intermediaries or to flow-thru entities that have withholding obligations on partners or beneficiaries.[34]

II. Issuer versus Paying Agent Reporting and Withholding

A. Publicly-Traded Securities. Special rules are provided for debt and equity that is regularly traded on an established securities market. The final regulations clarify that an interest is not regularly traded if the holder of the interest (other than a financial institution acting as an intermediary) is registered on the books of the investment entity. This rule does not apply to the extent a holder's interest is registered prior to January 1, 2014 on the books of the investment entity. The final regulations exclude debt or equity interests in an investment entity that are regularly traded because such interests are typically held through other financial institutions, so that reporting by the issuing entity is not necessary to fulfill the purposes of FATCA. Where that is not the case, the final regulations clarify that such interests are treated as financial accounts.

B. Transfer Agents. Comments requested that a transfer agent's obligations as a withholding agent be limited to the obligations of the principal on behalf of which the transfer agent acts in order to avoid duplication. The final regulations provide that merely acting as an agent with respect to a financial account belonging to the principal will not cause the agent to also have a financial account for that customer unless the agent would be treated as having the financial account independent of its actions as an agent.[35] An agent that makes a payment on behalf of a principal is a withholding agent with respect to the payment and has the same responsibility to determine the FATCA status of the payee and withhold, if required as it would for regular income tax purposes. However, in order to minimize duplication, the final FATCA regulations permit the agent to rely upon documentation collected by the principal or a certification by the principal that appropriate documentation has been collected.

The final FATCA regulations provide that a stock transfer agent that records transfers of stock for a corporation are not subject to FATCA if the activities of the agent is such that the agent ordinarily would not know the gross proceeds from sales.[36]

C. Introducing Brokers. An executing broker may rely on a certification of the introducing broker indicating (i) the introducing broker's determination of a payee's FATCA status and (ii) that the introducing broker holds valid documentation sufficient to determine the payee's FATCA status for any readily tradable financial instruments. In order for the executing broker to rely on the due diligence performed by the introducing broker, the introducing broker must be either a U.S. person (including a U.S. branch that is treated as a U.S. person) that is acting as the agent of the payee; or a PFFI or a reporting Model 1 FFI that is acting as the agent of the payee.

The final FATCA regulations also clarify that an entity that completes money transfers by instructing agents to transmit funds is not in a banking or similar business because it does not accept deposits or other similar temporary investments of funds.

D. Multiple FATCA Withholding Agents. The proposed FATCA regulations could be read to provide that a single account could be maintained by multiple entities (such as both a collective investment vehicle and its transfer agent), thereby creating multiple documentation, reporting, or withholding obligations for each entity. The final regulations identify the entity that will be treated as maintaining a financial account in order to avoid requiring multiple entities to document, withhold, and report with respect to a financial account. The final FATCA regulations provide that interests in an investment fund that are issued through a transfer agent or a distributor that does not hold the interests as a nominee of the account holder are considered issued directly by the fund.

E. Payments Made to US Intermediaries. A person that makes a withholdable payment to a USFI that is acting as an intermediary or agent generally may treat the USFI as the payee. [37] In all other cases, a person that makes a withholdable payment to a U.S. person and has actual knowledge that the person receiving the payment is acting as an intermediary or agent of a non-U.S. person, must treat such foreign person as the payee of such payment.

F. Payments to Disregarded Entities. In general, a person that makes a withholdable payment to a disregarded entity must treat the owner as the payee.[38] Special rules are provided for bank branches under which the branches are respected as persons.

III. Rules Affecting U.S. Branches of FFIs

A. Payments Made to U.S. Branches. The final FATCA regulations permit a withholding agent to presume that a payment made to a U.S. branch of certain banks and insurance companies is a payment of income that is effectively connected with a trade or business within the United States (and thus not a withholdable payment) if the withholding agent obtains a GIIN that enables the withholding agent to confirm that the FFI is a PFFI or registered deemed-compliant FFI.[39] In these cases, no withholding is required because the U.S. branch of the FFI is treated as a U.S. person. The IRS stated that conforming changes will be made to the presumption rule in the regular income tax withholding tax area to provide consistency with the rule set forth in the final FATCA regulations.

A U.S. branch is eligible for the benefits of the presumption rules if it is a U.S. branch of a foreign bank subject to regulatory supervision by the Federal Reserve Board or a U.S. branch of a foreign insurance company required to file an annual statement on a form approved by the National Association of Insurance Commissioners with the Insurance Department of a State, a Territory, or the District of Columbia. A payment is treated as made to a U.S. branch of a foreign bank or foreign insurance company if the payment is credited to an account maintained in the United States in the name of a U.S. branch of the foreign person, or the payment is made to an address in the United States where the U.S. branch is located and the name of the U.S. branch appears on documents (in written or electronic form) associated with the payment (for example, the check mailed or letter addressed to the branch).[40]

B. FATCA Obligations of U.S. Branches. A U.S. branch of a PFFI that is treated as a U.S. person for regular withholding tax purposes[41] is subject to special requirements to fulfill the withholding, due diligence, and reporting requirements of a U.S. financial institution to the extent provided under the FATCA rules and back-up withholding rules. Specifically, a U.S. branch of a participating FFI that is treated as a U.S. person and that satisfies its backup withholding obligations with respect to accounts held at the U.S. branch by account holders that are treated as U.S. non-exempt recipients for backup withholding tax purposes will be treated as satisfying its FATCA withholding obligation with respect to such accounts. Additionally, such a U.S. branch is required to file a separate Form 1042 to report amounts subject to reporting under the FATCA rules and any taxes withheld. A U.S. branch of a PFFI that is not treated as a U.S. person is required to fulfill the general requirements set forth in the final FATCA rules for withholding, due diligence, and reporting.

C. Withholding Responsibility. Certain FFIs do not have the systems capabilities to withhold U.S. taxes. In recognition of this fact, the FATCA statute allows FFIs to delegate withholding responsibilities to payers of income to the FFI and its account holders.[42] The final FATCA regulations permit U.S. branches to assume this responsibility to withhold U.S.-source income.[43] In addition, U.S. branches are

included in the definition of a FATCA withholding agent.[44]

D. Due Diligence and Reporting Requirements of U.S. Branches. While we explore the due diligence requirements in greater detail herein, it is worth noting that the final FATCA regulations specifically provide that U.S. branches of PFFIs are not subject to the due diligence requirements that are applicable to PFFIs.[45] In addition, U.S. branches may rely on the documentation used to determine regular income tax withholding in determining the FATCA status of payees. A U.S. branch of a participating FFI that is treated as a U.S. person shall be treated as having satisfied the FATCA reporting requirements if it files backup withholding reports with respect to account holders that are U.S. non-exempt recipients and FATCA reports on substantial U.S. owners of certain NFFEs.

IV. Hedge Funds and Other Investment Entities

The proposed regulations treated hedge funds as FFIs. While the final regulations generally incorporate the definition of an "investment entity" contained in the IGAs, they go much further.[46] The final regulations continue to treat hedge funds as FFIs, and not as NFFEs. Specifically, the final regulations treat an entity as a financial institution to the extent such entity's gross income is primarily attributable to investing or trading in certain financial assets and the entity is managed by a financial management company.[47] The final regulations also treat a non-U.S. entity that holds itself out as a CIV, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle as an FFI.[48] Passive entities, such as trusts, that are not professionally managed are generally treated as passive NFFEs rather than as FFIs.[49]

V. Securitization Vehicles

The terms of most securitization vehicles do not permit the vehicles to comply with the registration and due diligence requirements in the FATCA regulations. In most cases, the trustee would not be permitted to register the vehicle as a PFFI or comply with the due diligence requirements of a PFFI unless the trust indenture requires the trustee to do so, the trustee is required to do so under a provision of law, or all of the investors in the vehicle agree to amend the trust agreement to provide the trustee with the power to act in such a manner. In order to provide time to address these limitations, the final regulations permit these entities to qualify as deemed-compliant FFIs through 2016.[50] After December 31, 2016, the deemed-compliant status of these entities terminates, and each such entity will be required to comply with the terms of any applicable IGA or otherwise register as a PFFI.

In order for a securitization vehicle to qualify for the pre-2017 transitional rule, it must meet five requirements:

1. It must be organized as a trust or "similar fiduciary relationship" and be characterized as an FFI solely because it is an investment entity offering interests to unrelated investors;
2. It must have been in existence on December 31, 2011 and require liquidation prior to a set date and cannot be amended without the consent of 100% of the investors;
3. The Trust was formed for purchasing and holding specific types of debt instruments for its entire existence;
4. All payments made to investors must be made through a clearing organization that is FATCA-compliant or a PFFI, an FFI located in an IGA country or a USFI; and
5. The Trust Indenture must limit the activities of the Trustee and not authorize the Trustee to conduct the due diligence required by

FATCA, even if the failure of the Trustee to conduct the due diligence would otherwise result in withholding on the Trust.

VI. IGAs

A. Background. Since the proposed regulations were issued in February, IGAs have been signed with the United Kingdom, Ireland, Denmark, and Mexico. IGAs have been "initialed" with Switzerland, Norway and Spain. IGAs are designed to facilitate the transfer of tax information to the IRS and provide a mechanism for the other country to permit the transfer of such data by modifying the applicable local law restrictions that would otherwise prohibit the transfer. Treasury has adopted two different Model IGAs. The Model I IGA generally provides for the other jurisdiction's tax authority to act as intermediary regarding the automatic transfer of data to the IRS and may contain a reciprocity clause that would require the IRS to transfer certain data to the other jurisdiction in the future. The Model II IGA generally does not require the other jurisdiction to act as intermediary regarding the transfer of data and does not contain an automatic information exchange provision. Instead, the Model II IGA provides for each financial institution in such jurisdiction to enter into its own FFI agreement with the IRS to transfer data after a suitable waiver is obtained from affected clients.[51] Each of the Model I and Model II IGAs contain definitions, due diligence procedures and timelines regarding information exchange that differed from the proposed regulations.

B. The Final Regulations. The final regulations generally harmonize the IGA definitions and timelines with those contained in the Final Regulations. As a preliminary matter, the final regulations generally provide that FFIs located within Model I IGA jurisdictions are not obligated to enter into an FFI Agreement with the IRS. Accordingly, such FFIs are obligated to comply with the due diligence rules contained within the applicable Model I IGA and otherwise comply with the local laws that implement that Model I IGA, including the requirement to transfer certain information to its tax authority for subsequent transfer to the IRS. Financial institutions located within a Model II IGA jurisdiction will be obligated to fully comply with the final regulations, except as modified by the relevant Model II IGA (generally relating to due diligence and documentation requirements).

As discussed further below, it is contemplated that FFIs within IGA jurisdictions (including those within a Model I IGA jurisdiction) will need to register with the IRS. A financial institution located in a Model II IGA country must enter into an FFI agreement.

The final regulations seek to conform certain definitions of key terms with such terms as used in Model I and Model II IGAs. There are obviously benefits to FFIs to the extent that these revised definitions lead to certain reductions in burden that were granted in the IGA context It is unclear whether IGAs will provide a prospective IGA partner and its financial institutions with the same level of benefit (or burden reduction compared to implementing FATCA under the final regulations) as was the case pursuant to the proposed regulations.

VII. Insurance

As a general matter, the final regulations substantially modify the manner in which FATCA applies to insurance companies, their products and persons treated as holders of such products. Notably, the final regulations revised the grandfathered obligation rules to clarify their application to insurance products existing as of January 1, 2014. The final regulations treat certain insurance contracts existing prior to January 1, 2014 and the premiums paid with respect to such contracts as grandfathered obligations. The final regulations also clarify whether an insurance company that is not a specified insurance company (e.g., one that does not issue cash value insurance contacts or

annuities) is considered an FFI or an NFFE. The final regulations also clarify that certain reinsurance contracts between insurance companies are excluded from the definition of financial account.[52] These modification are likely to reduce the impact of FATCA on the insurance industry.

In instances where account identification is required, the final regulations generally modify the rules regarding identification of preexisting accounts. The final regulations generally permit an insurance company to presume that the beneficiary of a policy is a non-US person unless such person is known to have U.S. indicia. Additionally, the final regulations also modify the rules regarding the identification of the "holder" of the policy and generally provide that the holder is the person that can change the beneficiary or access the value of the policy. If no such person exists, then the insured and each beneficiary is treated as the holder. Finally, the regulations provide that the holder of an obligation is the person or persons to whom a payment would be made when the obligation to pay under the insurance contract becomes fixed.

The final regulations also address the interaction of non-US insurance companies that make an election to be taxed as if they were a U.S. insurance company. As a general matter, an insurance company that makes such an election will be treated as a U.S. person for purposes of FATCA only if it is licensed to do business in a state such that it would be obligated to conduct information reporting. Moreover, the final regulations clarify that small insurance companies that satisfy the requirements of Code § 501(c)(15) are not excluded from FFI status because they are considered tax exempt entities.

The final regulations made a number of revisions to the rules associated with cash value insurance contracts. In response to comments, the final regulations exclude cash value insurance contracts with a value below $50,000 from the definition of financial account. Additionally, the final regulations provide that in certain instances an advance premium or premium deposit paid to an insurance company will not be considered to be a depository account. The final regulations also modify the rules applicable to ascertaining the value of a cash value insurance contract or annuity.

VIII. Due Diligence and Documentation

In an effort to reduce the administrative burdens associated with identifying U.S. accounts, the final FATCA regulations made a number of changes to the due diligence and documentation procedures for FFIs.

A. Due Diligence. In Announcement 2012-42,[53] the IRS addressed concerns relating to the lack of time that financial institutions had in order to comply with the proposed regulations' time frame for performing due diligence procedures to identify and document its accounts. As a result, Announcement 2012-42 noted, and the final regulations adopted, a modified time frame for performing due diligence procedures as compared to the proposed regulations. As a practical matter, this modified time frame generally benefits U.S. financial institutions (USFIs) and FFIs. An example of the modified time frame includes the obligation of an FFI to perform the requisite identification and documentation procedures within six months of the effective date of its FFI Agreement for any account holder that is a *prima fa*cie FFI, and within 2 years of the effective date of its FFI Agreement for all other entity accounts.[54]

Generally, the framework for performing due diligence procedures suggested in the proposed regulations is essentially the same as the framework that was adopted in the final regulations, including separate rules that apply to USFIs and FFIs, separate due diligence procedures for accounts held by entities and accounts held by individuals, and separate rules that apply to pre-2014 and post-2014 accounts. These due diligence procedures to identify accounts are substantially modified pursuant to

IGAs. FFIs located in an IGA country are required to comply with the procedures provided by the applicable IGA (unless the intergovernmental agreement provides otherwise), as opposed to the procedures provided by the final regulations.

B. Documentation. The documentation rules contained in the proposed regulations required that withholding certifications[55] or other specified documentation be provided by the payee in order to certify or establish the FATCA status of a payee or beneficial owner. Such information would be used to determine whether the accountholder has any U.S. indicia. In many cases, the final regulations adopted the same rules as provided in the proposed regulations. In an important change, however, the final FATCA regulations permit reliance upon a certification provided by a PFFI if the PFFI is acting as an agent of the payee with respect to an obligation and receiving all payments made by the withholding agent with respect to that obligation on behalf of the payee.

The final regulations modify what documentation is required for what purpose, when is the documentation required to be "refreshed," and the use of existing documentation. Examples of such modifications include (i) the reliance upon a pre-FATCA IRS Form W-8 in lieu of obtaining an updated version of the withholding certificate in certain circumstances,[56] and (ii) an FFI's use of existing documentation to treat a new account of a customer with a pre-existing account as a pre-existing account. As a general matter, this wider scope of permissible documentation facilities the identification of accountholders and should make it slightly less burdensome for financial institutions and their accountholders to comply with FATCA.

USFIs will collect withholding certificates in order to identify its accountholders. FFIs will collect withholding certificates, substitute forms, local language forms,[57] and will rely on other documentation set forth in the final regulations and on anti-money laundering (AML) data that is collected in the institution's ordinary course of business. It is also worth mentioning that the final regulations allow documentation to remain valid indefinitely, subject to a change in circumstances, as opposed to a validity period of three years. The preamble to the final regulations states that Treasury and the IRS are considering extending this indefinite validity rule to regular income tax withholding in appropriate circumstances.[58]

IX. Financial Accounts

The concept of a "financial account" is a key definition under FATCA. Specifically, the FATCA statute requires reporting with respect to financial accounts that are treated as United States accounts.[59] The statue specifically provides that custodial accounts, depositary accounts and debt or equity instruments in FFIs are financial accounts.[60] The proposed FATCA regulations took an expansive approach to when a financial account would be considered to exist, but the IGAs took a more narrow approach.

The final regulations adopt a definition of financial account that is more closely aligned with the definitions used in the Model IGAs. As a general matter, depository accounts, custodial accounts and debt or equity interests in "investment entities" are all financial accounts. The final regulations also substantially modify the concept of financial accounts with respect to products offered by an insurance company and are discussed separately herein in the section addressing insurance.

The final FATCA regulations exclude certain escrow accounts and negotiable instruments that are regularly traded on regulated or over the counter (OTC) markets. The definition of depository account is clarified to provide that a depository account must be maintained by a financial institution that is engaged in a banking or similar business for which the institution is obligated to give credit. The final regulations also provide that a depository account includes

any amount held by an insurance company under a guaranteed investment contract or similar agreement that bears interest or requires the return of the amount held.

Certain debt or equity interests are considered financial accounts. The final regulations modify these requirements to address the revised definition of investment entity and to reflect certain special rules for those interests regularly traded on established securities markets,[61] interests in holding companies of FFI groups, and interests whose value is determined, in part, by reference to assets that produce withholdable payments. The final regulations also modify the exceptions that would exclude certain pension, retirement and nonretirement accounts from the definition of financial account.

X. Responsible Officer Certifications

The proposed regulations stated that FFIs would be obligated to make a variety of certifications regarding compliance with the regulations, including the completion of the requisite due diligence requirements and a certification relating to past practices and polices of the FFI. Many FFIs expressed concerns regarding this certification process and the process by which the IRS would verify a FFI's compliance with the applicable rules. The final regulations clarify these certification and impose certain complex ongoing verification procedures. The final regulations incorporate the verification procedures in the section relating to FFI Agreements, which suggests that only those FFIs that are obligated to enter into FFI Agreement will be obligated to comply with these verification rules. However, some uncertainty remains with respect to how these certification procedures will apply to FFIs that are located in jurisdictions that have entered into Model I IGAs with the United States.

A PFFI may not assist clients in avoiding FATCA. In response to numerous comments requesting clarification of the certification requirements, the final regulations provide new examples of policies that would be deemed to assist account holders in avoiding FATCA, such as advising clients to transfer or close accounts in order to avoid reporting or advising that an account holder remove U.S. indicia from its account information to avoid reporting. The regulations clarify the nature of the review process that must occur internally in order to make the applicable certification. The regulations also address the process that would be used if a responsible officer is not able to make the required certification and permit the use of a qualified certification and a description of the corrective action that would be taken by the responsible officer.

The final regulations contain a verification process that would be used as a basis to ensure compliance with the FFI agreement. The procedures generally require a responsible officer to enact appropriate policies, procedures and processes sufficient to ensure that the FFI is able to comply with its FFI agreement. For this purpose a responsible officer may be an officer of the PFFI or a reporting Model I FFI within the same expanded affiliated group as the PFFI. The requirements of a responsible officer may be delegated to others but such person is required to make all required certifications. The results of periodic reviews of a PFFIs compliance program will form the basis for the periodic certifications by the responsible officer to the IRS.

Generally, the certifications required by the verification process will be made every third year and are based on an internal audit of the PFFIs policies and procedures and its internal oversight process. During the verification process, the responsible office will need to determine whether there were any material failures with respect to the PFFI's satisfaction of its obligations under its FFI Agreement. For this purpose, a material failure is a deliberate action by the PFFI to avoid the requirements of such agreement or a failure due to insufficient internal controls.[62]

It is expected that the IRS will review the information reporting forms and other information provided by an PFFI to the IRS in order to ascertain the PFFI's compliance with its FFI Agreement. The IRS may make inquires to the responsible officer in order to determine whether there was substantial non-compliance with the PFFI's FFI Agreement. The IRS may dictate that certain corrective action be undertaken, such as, the performance of specified review procedures (including an external audit). Failure to abide by such corrective action may lead to negative consequences, including a determination that an event of default has occurred that could lead to the termination of the FFI Agreement.

XI. Deemed Compliant FFIs

The final FATCA regulations make several modifications and clarifications concerning deemed-compliant FFIs.[63] Registered deemed-compliant FFIs now include FFIs that are treated as such under a Model II IGA and a reporting Model l FFI that complies with applicable registration requirements. In addition, the final FATCA regulations add as categories of deemed-compliant FFIs: (1) qualified credit card issuers; (2)certain closely held sponsored investment entities and controlled foreign corporations; and (3) certain limited life debt investment entities.

In addition, the deemed- compliant category of FFI for retirement plans has been combined with the exempt beneficial owner category for a retirement fund and nonprofit organizations have been removed as a category of deemed-compliant FFI and are now treated as excepted NFFEs.

XII. The Registration Process

FFIs will register with the IRS through a secure online web portal, the FATCA Registration Portal. The Regulations do not describe the use of the Portal. However, the Preamble makes clear that the registration process is intended to be entirely paperless. It is expected that FFIs will use the Portal to register their FATCA status, manage registration information, agree to terms of the FFI agreement, and obtain a GIIN. FFIs that are subject to either a Model l or Model II IGA also will use the Portal to register their FATCA status and obtain a GIIN. The Portal will also be used to renew the QI status of registering FFIs.

The Regulations provide that a PFFI, a reporting Model l FFI or a USFI may agree to act as a "compliance FFI" for some or all members of its expanded affiliated group. The compliance FFI will be the sponsoring entity for the group and will facilitate registration for members of the sponsored group and provide group compliance certifications.

XIII. Concluding Remarks

The size and scope of the final FATCA regulations make clear that FATCA is a tax code in and of itself that has been housed in the Internal Revenue Code. It is hard to imagine that Congress fully appreciated the burden that it was placing on the IRS and taxpayers alike when it passed the FATCA provisions into law. We have liaised personally with a number of the individuals at the IRS who worked so hard on these regulations and we applaud their dedication to providing administrable rules for taxpayers to work with. Nonetheless, we expect that it will require significant effort for affected financial institutions to implement the FATCA due diligence and withholding regime within the applicable timeframes and coordinate compliance among affiliates located in differing IGA jurisdictions.

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Endnotes

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

[2] *See* Code § 1471(d)(2) (financial accounts include depository accounts, custodial accounts and debt and equity investments in the FFI).

[3] Code § 1471(a); Prop. Treas. Reg. § 1.1471-2(a)(1).

[4] Code § 1473(1)(A).

[5] Code § 1474(b)(2)(a)(ii).

[6] Recalcitrant account holders are defined as persons who fail to comply with requests for information or fail to provide a waiver of foreign law, if requested to do so. Code § 1471(d)(6).

[7] REG-121647-10 (February 8, 2012)

[8] 2010-37 I.R.B. 329.

[9] 2011-19 I.R.B. 765.

[10] 2011-32 I.R.B. 124.

[11] 2012-47 I..RB. 561

[12] Treas. Reg. § 1.1471-5(f)(1)(i)(C) (CIVs). For FATCA purposes, CIVs are treated as such only if the persons who hold debt and equity interests in the CIV are limited to the types of persons enumerated in Treasury Regulation § 1.1471-5(f)91)(i)(C)(2).

[13] Treas. Reg. § 1.1471-5(f)(1)(D)(1)

[14] Treas. Reg. § 1.1471-5(f).

[15] Treas. Reg. § 1.1471-5(f)(1)(C)(2).

[16] Treas. Reg. § 1.1471-5(f)(1)(D).

[17] Treas. Reg. § 1.1471-2(a)(1). Payments made to NFFEs are not subject to FATCA withholding if (i) the beneficial owner of such payment is the NFFE or any other NFFE; (ii) the withholding agent can treat the beneficial owner of the payment as an NFFE that does not have any substantial U.S. owners, or as an NFFE that has identified its substantial U.S. owners; and (iii) the withholding agent reports the information relating to any substantial U.S. owners of the beneficial owner of such payment.

[18] Treas. Reg. § 1.1471-4(b)(1).

[19] Treas. Reg. § 1.1472-1(b)(2).

[20] Treas. Reg. § 1.1471-1(b)(96). Additional rules apply for determining pre-existing obligations for registered deemed-compliant FFIs.

[21] Treas. Reg. § 1.1471-2(a)(4)(ii)(B).

[22] Treas. Reg. § 1.1471-2(a)(4)(ii).

[23] Treas. Reg. § 1.1472-1(b)(2).

[24] Treas. Reg. § 1.1471-1(b)(88).

[25] Treas. Reg. § 1.1471-2(b).

[26] Treas. Reg. § 1.1471-2(b)(3).

[27] Treas. Reg. § 1.1471-2(b)(2)(ii).

[28] Treas. Reg. § 1.1471-2(b)(2)(iii).

[29] Treas. Reg. § 1.1471-2(b)(4)(ii).

[30] Treas. Reg. § 1.1471-4(e)(1)(v).

[31] Treas. Reg. § 1.1473-1(a)(1)(ii).

[32] Treas. Reg. § 1.1471-1(b)(82).

[33] Treas. Reg. §1.1473-1(a)(4)(vi).

[34] *Id.*

[35] Treas. Reg. § 1.1471-3(a)(9)(iv).

[36] Treas. Reg. § 1.1471-1(b)(9).

[37] Treas. Reg. § 1.1471-3(a)(3)(iii).

[38] Treas. Reg. § 1.1471-3(a)(v).

[39] *See* Treas. Reg. § 1.1471-1(b)(126).

[40] Treas. Reg. 1.1471-3(f)(6).

[41] *See* Treas. Reg. § 1.1441-1(b)(2)(iv).

[42] Code § 1471(b)(3).

[43] Treas. Reg. § 1.1471-1(b)(6).

[44] Treas. Reg. § 1.1471-1(b)(135).

[45] Treas. Reg. § 1.1471-4(c)(1)(v).

[46] Treas. Reg. § 1.1471-5(e)(4)(i)(A). A financial institution now includes any entity that primarily conducts as a business on behalf of customers: (i) trading in specified financial instruments, (ii) individual or collective portfolio management, or (iii) otherwise investing, administering or managing funds, money or financial assets on behalf of other persons.

[47] Treas. Reg. § 1.1471-5(e)(4)(i)(B).

[48] Treas. Reg. § 1.1471-5(e)(4)(i)(C).

[49] T.D. 9610, p. 67.

[50] Treas. Reg. § 1.1471-5(f)(2)(iv).

[51] If a client refuses to provide the requisite waiver, the other jurisdiction agrees to act on a treaty-based information exchange request to provide data regarding such person.

[52] It should be noted that this exclusion only applies when the parties to the reinsurance agreement are insurance companies and would not apply to a non-insurance company that is party to such reinsurance contract.

[53] 2012-47 I.R.B. 561 (11/19/2012).

[54] Treas. Reg. § 1.1471-4(c)(3)(ii).

[55] Treas. Reg. § 1.1471-3(d)(1).

[56] *Id.*

[57] The final regulations also permit documentation alternatives in foreign languages – substitute forms may be both prepared in and filled out in a foreign language,

provided the withholding agent furnishes the IRS with a translated version upon request. Treas. Reg. § 1.1471-3(c)(6)(v).

[58] T.D. 9610, p 26.

[59] Code § 1474(d)(1).

[60] Code § 1471(d)(2).

[61] It should be noted, however, that the final regulations fail to contain the correct cross reference to this rule. Moreover, the final regulations also resolve the challenge of newly organized entities satisfying the regularly traded test, although the solution appears overly complex.

[62] Treas. Reg. §1.1471-4(f)(3)(iv) provides examples of material failures and includes any reserve created or established relating to potential future tax liability related to the PFFI's compliance with its FFI agreement.

[63] Treas. Reg. Sec 1.1471-5(f)

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