

It's Always a Day Away: The IRS Postpones FATCA Withholding

Through an odd set of events, the oldest of the authors of this Legal Update attended opening night of the original production of *Annie* in 1977. Being the precocious teenager that he was, he left the theater and promptly declared that what is now one of the most beloved shows ever made would close before the end of the week. Predictions regarding the effective date of the Foreign Account Tax Compliance Act (“FATCA”) now appear equally erroneous. Moreover, the Internal Revenue Service (the “IRS”) must have been listening to *Tomorrow*, the show’s theme song, when thinking about the implementation challenges presented by FATCA. Specifically, on July 12, 2013, the IRS released Notice 2013-43, and the Treasury announced that it was engaged in more than 80 intergovernmental agreement (“IGA”) negotiations.¹ This Notice (i) delays many timelines for the implementation of FATCA to accommodate new IGA counterparties and systems challenges and (ii) accelerates the effective date of signed, but not-yet-implemented, intergovernmental agreements with respect to FATCA.

On July 12, 2013, the US Treasury Department released new versions of both of the Model 1 and Model 2 IGAs. The IGA versions reflect the timelines provided by Notice 2013-43.

The Briefest of Backgrounds

The FATCA provisions, contained in Sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended (the “Code”), provide 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 US 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 US federal income tax withholding.³ Withholdable payments include items of US-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 US-source income and will not be able to recover the withheld amounts. Withholding rules are also imposed on United States financial institutions (“USFIs”), which include US branches of FFIs.

The FATCA withholding rules are both complemented and overridden for FFIs in jurisdictions that have entered into an IGA with the United States. FFIs in such countries generally follow the documentation and information reporting obligations specified in the IGA instead of the FATCA statutes and regulations.

Final regulations issued in January 2013 required FATCA withholding as early as January 2014 for accounts opened after such date.⁶ While withholding on preexisting accounts was scheduled to be effective in 2016, withholding on payments to *prima facie* FFIs that were not FATCA-compliant was scheduled to commence for payments made after June 30, 2014.⁷ As described below, certain of these effective dates have been postponed by at least six (6) months by virtue of the guidance delivered in Notice 2013-43. In addition, the IRS has provided flexible rules for FFIs that are resident in non-US jurisdictions that have signed, but not implemented, an IGA.

The Revised Withholding and Grandfathering Effective Dates

NEW ACCOUNTS

An account opened by a non-US person will be subject to the full array of FATCA due diligence and withholding if it opened on or after July 1, 2014. In the case of FFIs located in an IGA jurisdiction, a new account is one opened by the later of July 1, 2014 and the effective date of its FFI Agreement. Under the final regulations, due diligence and withholding would have been required for accounts opened on or after January 1, 2014. For FFIs, a midyear effective date is likely to prove to be extremely challenging because system changes generally are made for calendar years. Notice 2013-43 does not otherwise affect the dates by which withholding must commence if a payee is determined not to be FATCA-compliant. Specifically, the Notice does not affect the timing provided in the final FATCA regulations for withholding on gross proceeds (January 1, 2017),⁸ foreign passthru payments (no earlier than January 1, 2017),⁹ and payments of US source FDAP income with respect to offshore obligations by persons not acting in an intermediary capacity (January 1, 2017).¹⁰

GRANDFATHERED OBLIGATIONS

Payments on certain obligations, generally, instruments that are treated as other than equity for US tax purposes,¹¹ that are “grandfathered,” are not subject to withholding under FATCA.¹² Previously, obligations and associated collateral outstanding on January 1, 2014 (and possibly later, in the case of obligations that produce “dividend equivalent payments” or “foreign passthru payments”) were considered grandfathered obligations.¹³ The Notice provides that the definition of grandfathered obligation will be revised to include obligations that are outstanding on July 1, 2014.

PREEXISTING ACCOUNTS

Preexisting accounts are subject to special rules. For USFIs, the definition of a preexisting account will be modified to include any account outstanding on July 1, 2014, instead of January 1, 2014. For participating FFIs (“PFFIs”), that is, a FATCA-compliant FFI, an account is treated as a preexisting account if it was open on the effective date of its PFFI Agreement. The Notice is unclear regarding whether a PFFI will be able to register as a PFFI prior to July 1, 2014, but contains language suggesting that it may be possible for such an FFI to register as a PFFI as early as January 1, 2014. Accordingly, PFFIs should carefully consider whether to register as of January 1, 2014 or July 1, 2014 (if this is in fact a choice) as this choice may affect whether an account is a preexisting account.

FFIs located in IGA jurisdictions, however, may treat accounts outstanding as of the later of July 1, 2014 and the effective date of their registration as grandfathered accounts as preexisting accounts, even if the IGA provides for a January 1, 2014 cutoff date. In Notice 2013-43, the IRS noted that the “most-favored nation” provisions in the signed IGAs allow it to make this change.

Although the Notice is not entirely clear, the IRS has confirmed that the dates by which withholding must be commenced on preexisting accounts are deferred by Notice 2013-43. Under the Notice, provided the payer does not have information that the payee is a (i) nonparticipating FFI or (ii) *prima facie* FFI, withholding will not be required on payments made before July 1, 2016.¹⁴ Under the rule for payments to non-financial foreign entities (“NFFEs”), withholding will not be required on payments made prior to July 1, 2016 unless the payer has information that the payee is a *prima facie* FFI.

PRIMA FACIE FFI DUE DILIGENCE AND WITHHOLDING

Payers of withholdable payments will not be required to identify and potentially withhold on payments made to *prima facie* FFIs prior to January 1, 2015. The Notice does not change the general effective date for withholding on payments to non-US persons

Six-Month Delay for FFI Registration

The FATCA registration website for FFIs that desire to register to be treated as PFFIs is projected to be accessible on August 19, 2013 (not July 15, 2013, as previously expected), but FFIs will be able to amend their registration at any time until January 1, 2014. Consistent with this six-month extension, the IRS will not issue any Global Intermediary Identification Numbers until 2014. FFIs need to finalize their registration by April 25, 2014 to ensure inclusion in the first published FFI list. The delay should enable FFIs to gather the information needed to register more members of their expanded affiliated group in an initial filing.

PFFIs No Longer Need to Report on 2013

Though the due date of the first report required from a PFFI has not changed (March 31, 2015), PFFIs will only be required to report on its US accounts with respect to the 2014 calendar year

in this first report. This change is intended to apply in the context of Model 1 IGAs as well.

Jurisdictions with Signed IGAs

The IRS is now allowing FFIs located in countries that have signed but not implemented IGAs with the US to be treated as though the IGA was implemented. Specifically, a jurisdiction will be treated as having in effect an implemented IGA if the jurisdiction is listed as such on a list to be released by the Treasury Department. This rule alleviates the issue with the fact that there are delays in foreign jurisdictions in developing local implementation rules. FFIs in listed jurisdictions can register with the IRS as registered deemed-compliant FFIs and obtain GIINs prior to the actual signing of the IGA.

Extensions on Chapter 3 Documentation

Withholding documentation, including Forms W-8, for regular income tax withholding purposes is valid only until the expiration of the third calendar year after the year in which it is signed (or until there is a change in withholding status).¹⁵ For both regular income tax purposes and for FATCA purposes, Notice 2013-43 extends the validity period for Forms W-8 that would have expired on December 31, 2013 until July 1, 2014. The Notice does not change the obligation to obtain new documentation if there is a change in circumstances. Similarly, all qualified intermediary (QI), withholding partnership (WP), or withholding trust (WT) agreements that would otherwise expire on December 31, 2013, will be automatically extended until June 30, 2014.

FTRO Extension

The foreign-targeted registered obligation (FTRO) rules, which had been reinstated by IRS Notice 2012-20 but were scheduled to sunset at the end of 2013, have been extended to registered obligations that otherwise comply

with the FTRO rules and that are issued before July 1, 2014.

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Endnotes

- 1 US Treasury, Treasury Engaging with More than 80 Countries to Combat Offshore Tax Evasion and Improve Global Compliance (July 12, 2013).
- 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 Treas. Reg. § 1.1471-2(a).
- 7 See generally, Leeds, Sambur, Goldberger & Morris, 'Tis a Gift to Be Simple: IRS Issues Final FATCA Regulations, Daily Tax Report (January 23, 2013).
- 8 Treas. Reg. § 1.1473-1(a)(1)(ii).
- 9 Treas. Reg. § 1.1471-4(b)(4).
- 10 Treas. Reg. § 1.1473-1(a)(4)(vi).

- 11 Treas. Reg. § 1.1471-2(b)(2)(ii).
- 12 Treas. Reg. § 1.1471-2(b)(1).
- 13 Treas. Reg. § 1.1471-2(b)(2)(i).
- 14 Treas. Reg. § 1.1471-2(a)(4)(ii)(A).
- 15 Treas. Reg. § 1.1441-1(e)(4)(ii).

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