

## FATCA Transitional Rules Extended

Financial institutions, partner jurisdictions and affected stakeholders have been working to implement the Foreign Account Tax Compliance Act (“FATCA”) since its enactment in March 2010. Time and again, as key implementation dates draw near, stakeholders redouble their efforts to satisfy these deadlines. Nonetheless, some stakeholders are not as prepared as others to move forward. Rather than risk potential disruption and, possibly, failure of the entire implementation process, the US Department of the Treasury (“Treasury”) and the US Internal Revenue Service (“IRS”) have, in the past, seen fit to graciously extend previously announced deadlines. This is the case with Notice 2015-66 (the “Notice”). Specifically, the Notice announces that the IRS will amend the FATCA regulations to provide additional time for withholding agents and foreign financial institutions (“FFIs”) to modify their systems to address the phase-out of certain transitional rules, including those impacting withholding on gross proceeds and passthru payments, registration of sponsored entities and reporting by financial institutions in Model 1 Intergovernmental Agreement (“IGA”) jurisdictions.

### Extension of Dates for When Withholding Begins for Payments of Gross Proceeds and Passthru Payments

Under the existing FATCA regulations, withholding on payments of US-source FDAP (generally, interest and dividends) income began on July 1, 2014, and was scheduled to be

expanded to apply to any gross proceeds from the sale or other disposition of any property of a type that can produce US-source interest or dividends after December 31, 2016.<sup>1</sup> In order for an FFI to obtain the status of a participating FFI, it must agree to withhold on passthru payments made to recalcitrant account holders and nonparticipating FFIs.<sup>2</sup> A passthru payment is defined in the regulations to mean a withholdable payment and any foreign passthru payment. Under the existing FATCA regulations, a participating FFI is not required to withhold tax on a foreign passthru payment made to a recalcitrant account holder or a nonparticipating FFI before the later of January 1, 2017, or the date of publication in the *Federal Register* of final regulations defining foreign passthru payment.<sup>3</sup>

In an effort to continue to facilitate an orderly phase-in of FATCA withholding, the Notice states that Treasury and the IRS intend to amend the existing FATCA regulations such that withholding on gross proceeds will apply with respect sales occurring after December 31, 2018. The Notice also further extends the start date of withholding on foreign passthru payments to the later of January 1, 2019, or the date of publication in the *Federal Register* of final regulations defining the term “foreign passthru payment.” It is unclear, however, whether this additional extension is presently required, as the existing FATCA regulations tie the implementation of this rule to the later of the publication of final regulations relating to passthru payments or January 1, 2017.

## Extension of Limited Branch and Limited FFI Statuses

Subject to certain requirements set forth in an applicable intergovernmental agreement to implement FATCA (an “IGA”), in order for an FFI that is a member of an expanded affiliated group (“EAG”) to become FATCA-compliant, generally, each additional FFI that is a member of the EAG must also have a FATCA-compliant status. The FATCA regulations included a set of transitional rules that provided limited relief to FFIs with branches or affiliates that are located in jurisdictions whose laws prohibit such branches or affiliates from complying with an FFI agreement. These “limited” statuses (referred to as the “limited branch” and “limited FFI” rules) were set to expire after December 31, 2015, at which point an FFI member of an EAG may be required to forfeit its compliant-status without the benefit of these transitional rules due to a related entity’s non-compliance.

The Notice provides that the availability of limited branches and limited FFIs will be extended an additional year, and will terminate on January 1, 2017. Limited FFIs and limited branches that seek to continue such status during the 2016 calendar year will be required to edit and resubmit their registrations after December 31, 2015 on the FATCA registration website.

## Extension of Time to Register Sponsored Entities and Extension of Reliance on Sponsoring Entity GIINs

FATCA provides that certain types of entities are not subject to withholding because they are deemed to comply with the requirement to enter into and comply with the FFI Agreement (“deemed-compliant entities”). Certain deemed-compliant entities are required to register with the IRS in order to achieve their deemed-compliant status (a “registered deemed-compliant entity”), while other deemed-

compliant entities are permitted to certify to payors (without having to register with the IRS) their deemed-compliant status. Certain so-called “sponsored entities,” such as a sponsored investment entity or a sponsored controlled foreign corporation, may be required to register with the IRS in order to be considered a deemed-compliant entity and the entity that sponsors such an FFI must also register with the IRS (a “sponsoring entity”).<sup>4</sup>

Under the existing FATCA regulations, a sponsoring entity must register the sponsored registered deemed-compliant FFI with the IRS by the later of January 1, 2016, or the date that the FFI identifies itself as qualifying as a registered deemed-compliant FFI. Accordingly, since sponsored registered deemed-compliant FFIs were not required to be registered with the IRS prior to 2016, for payments prior to January 1, 2016, a withholding agent may rely on an IRS Form W-8 provided by a sponsored registered deemed-compliant FFI that includes only the GIIN (i.e., a FATCA identification number) of the FFI’s sponsoring entity.<sup>5</sup> In other words, prior to January 1, 2016, a sponsored registered deemed-compliant FFI was not obligated to provide its own GIIN to a withholding agent.

The IRS is currently developing a streamlined process for sponsoring entities to register their sponsored entities on the FATCA registration website, and it anticipates that this registration process will be available in the coming months. In order to provide sufficient time for sponsored entity registration, the Notice extends, by one year, the time for a sponsoring entity to register its sponsored registered deemed-compliant FFIs.

According to the Notice, Treasury and the IRS intend to amend the FATCA regulations by providing that sponsoring entities must register their sponsored registered deemed-compliant FFIs by January 1, 2017,<sup>6</sup> at which point sponsoring entities must use the GIIN of the sponsored entity when satisfying information reporting obligations by filing IRS Form 8966

(FATCA Report). Additionally, sponsoring entities must provide the GIIN of the sponsored entity to withholding agents making payments to the sponsored entity by January 1, 2017.

Sponsored entities located in a Model 1 IGA jurisdiction will maintain their deemed-compliant status so long as their sponsoring entity registers the sponsored entity on or before the later of December 31, 2016, and the date that is 90 days after a US reportable account is first identified. Sponsored entities located in a Model 2 IGA jurisdiction will maintain their deemed-compliant status so long as their sponsoring entity registers the sponsored entity on or before December 31, 2016.

For payments made prior to 2017, withholding agents may continue to rely on IRS Forms W-8 from sponsored registered deemed-compliant FFIs that only provide the sponsoring entity's GIIN. However, for payments made on or after January 1, 2017, a withholding agent will be required to obtain the GIIN of a payee that is a sponsored registered deemed-compliant FFI or a sponsored direct reporting NFFE. This can occur by obtaining an IRS Form W-8 from the payee that includes its GIIN, or, if the withholding agent already been provided such a Form that only contains the GIIN of the sponsoring entity, oral or written confirmation of the payee's GIIN (such as by e-mail).<sup>7</sup>

### Treatment of Collateral Under the Grandfathered Obligation Rule

The existing FATCA regulations provide that payments made pursuant to certain financial instruments (excluding equity) were not subject to withholding. These "grandfathered obligations" were limited to "obligations" (generally an instrument treated as debt for US tax purposes) outstanding on July 1, 2014. A grandfathered obligation also included an agreement requiring a secured party to make a

payment with respect to collateral posted to secure a grandfathered obligation. If collateral secures both grandfathered and non-grandfathered obligations, 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 (i.e., the *pro rata* rule).

To ease compliance burdens, the Notice provides that the IRS intends to make the *pro rata* rule for collateral that secures both grandfathered and non-grandfathered obligations optional. In lieu of applying the *pro rata* rule, the secured party will be permitted to treat the entire collateral as securing non-grandfathered obligations and withhold on all payments made with respect to the collateral. In addition, the IRS intends to amend the definition of grandfathered obligations to include any obligation that gives rise to substitute payments and that is created as a result of the payee posting collateral that is otherwise treated as a grandfathered obligation. Such substitute payments would therefore not be subject to withholding.

### Timing of Exchange of 2014 Information Under a Model 1 IGA

Treasury first released model intergovernmental agreements (the "Model 1 IGA" and the "Model 2 IGA") in 2012 to facilitate the implementation of FATCA and to address foreign legal impediments that otherwise would limit an FFI's ability to comply with FATCA. These Model IGAs have been updated periodically.

Many partner jurisdictions that have signed IGAs or reached an agreement in substance on the text of an IGA continue to work through their internal procedures to bring these IGAs into force. Accordingly, certain Model 1 IGA

jurisdictions are not yet authorized under local law to exchange data pursuant to the IGA. Thus, the Notice confirms that for Model 1 IGAs that have not yet entered into force on September 30, 2015, Treasury will continue to treat FFIs covered by the IGA as complying with FATCA (and therefore are exempted from FATCA withholding tax) so long as (i) the partner jurisdiction continues to demonstrate firm resolve to bring the IGA into force and (ii) any information that would have been reportable under the IGA on September 30, 2015, is exchanged by September 30, 2016, together with any information that is reportable under the IGA on September 30, 2016. This result is consistent with certain memoranda of understandings (“MOU”) between the United States and certain partner jurisdictions and extends such treatment to all jurisdictions without having to enter into a specific MOU with each partner jurisdiction.

For Model 1 IGAs that, pursuant to their terms, are in force, partner jurisdictions are generally required to exchange information with the IRS by September 30, 2015. In light of the practical challenges of implementing the infrastructure needed to exchange FATCA information, Treasury and the IRS are generally willing to provide additional time to effect the transmittal of FATCA data. Accordingly, the Notice provides that Treasury and the IRS will treat FFIs covered by an IGA as complying with, and not subject to withholding under, FATCA even if the relevant partner jurisdiction has not exchanged 2014 information by September 30, 2015, as long as (i) the partner jurisdiction notifies the US competent authority before September 30, 2015 of the delay and (ii) provides assurance that the jurisdiction is making good faith efforts to exchange the information as soon as possible. Accordingly, a partner jurisdiction that provides such notice to the US competent authority is not under any obligation to provide FATCA data by any particular date.

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## Endnotes

<sup>1</sup> Treas. Reg. § 1.1473-1(a).

<sup>2</sup> IRC § 1471(b)(1)(D)(i).

<sup>3</sup> Treas. Reg. § 1.1471-4(b)(4).

<sup>4</sup> Typically, a sponsoring entity of a sponsored registered deemed-compliant FFI must agree to perform, on behalf of the sponsored FFI, all due diligence, withholding, reporting, and other requirements that the sponsored FFI would have been required to perform if it were a participating FFI.

<sup>5</sup> Treas. Reg. § 1.1471-3(e)(3)(iv)(B).

<sup>6</sup> This also applies to sponsored direct reporting NFFEs.

<sup>7</sup> If a withholding agent obtains oral or written confirmation of the payee’s GIIN, it will be required to retain a record of such information, which will become part of the IRS Form W-8.

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