

IRS Changes FATCA Implementation Deadlines

The United States Internal Revenue Service recently issued Announcement 2012-42 (the Announcement), changing the deadlines for meeting due diligence and other requirements under the Foreign Account Tax Compliance Act (FATCA), provisions of which are contained in Sections 1471 through 1474 of the US Internal Revenue Code. The Announcement also clarifies the scope of so-called “grandfathered obligations,” which are exempt from at least certain FATCA requirements.

FATCA generally requires foreign financial institutions (FFIs) to enter into an agreement with the IRS (FFI Agreement). FFIs that enter into an FFI Agreement are “participating FFIs.” Under the FFI Agreement, participating FFIs are required to (i) identify and report certain information about their US accounts to the IRS, and (ii) withhold on “withholdable payments” and “foreign passthru payments,” defined below, made to “nonparticipating FFIs” (FFIs that do not comply with FATCA) and “recalcitrant account holders” (certain account holders that do not furnish required information to FFIs or that fail to provide waivers of foreign laws that would prevent reporting by FFIs to the IRS).

The term “withholdable payments” includes (i) US-source interest, dividends, wages and similar (fixed and determinable annual or periodical) payments, and (ii) gross proceeds from the sale or other disposition of property that can produce US-source interest or dividends. The term “foreign passthru payments” refers to payments made by participating FFIs that are attributable to withholdable payments received by them.

FFIs that fail to satisfy the requirements of the FFI Agreement in a timely manner are subject to a 30 percent withholding tax on withholdable payments made to them. The tax is withheld by a “withholding agent.” The term “withholding agent” generally refers to US (or certain non-US) persons that have the control, receipt, custody, disposal or payment of a withholdable payment or foreign passthru payment.

On February 15, 2012, the IRS released proposed regulations (Proposed Regulations), which are described in more detail in our client alert, “[IRS Issues Proposed FATCA Regulations](#),” published April 4, 2012, and which set forth rules to follow in satisfying requirements under FATCA. The IRS has also released several model intergovernmental agreements, which are described in more detail in our client alert, “[Treasury Department Releases Intergovernmental FATCA Agreement](#),” published August 1, 2012. These intergovernmental agreements provide FFIs in jurisdictions that enter into such agreements with an alternative approach to satisfy FATCA requirements.

Due Diligence Deadlines

The Proposed Regulations require participating FFIs to complete certain due diligence procedures by specified deadlines to (i) determine whether their account holders were US persons (subject to FATCA reporting) or recalcitrant account holders (subject to FATCA withholding), and (ii) determine whether any payees were nonparticipating FFIs (subject to FATCA withholding). The deadline for completing this due diligence depends on the type of account or payee, as described below:

- Under the Proposed Regulations, accounts, instruments or contracts executed on or after a specified date are treated as “new obligations.” The Proposed Regulations require participating FFIs to establish certain due diligence procedures as of the specified date to document new obligations. Obligations that are not new obligations are “pre-existing obligations.”
- The Proposed Regulations provide different diligence deadlines for documenting payees and/or account holders of preexisting obligations, that are (i) “prima facie FFIs” (generally, entities as to which a withholding agent has certain information indicating their status as FFIs) and (ii) entities other than prima facie FFIs.
- The Proposed Regulations provide different diligence deadlines for documenting pre-existing “high-value” individual accounts (generally, accounts with a balance exceeding \$1,000,000) and all other pre-existing individual accounts.

The Announcement's due diligence deadlines similarly depend on the factors described above, but the Announcement changes the actual deadlines. The following chart compares the deadlines applicable to participating FFIs under the Proposed Regulations and the Announcement.

Participating FFIs	Proposed Regulations (Prior Rules)	Announcement 2012-42 (New Rules)
Effective Date of FFI Agreement	An FFI Agreement entered into before July 1, 2013 has an effective date of July 1, 2013, while all other FFI Agreements are effective when entered into. Under prior guidance, the IRS provided that FFIs that enter into an FFI Agreement by June 30, 2013 are guaranteed not to be subject to withholding on payments made to them when withholding goes into effect on January 1, 2014. FFIs that enter into an FFI Agreement after June 30, 2013 but before January 1, 2014 will be treated as participating FFIs but may be subject to withholding if there is not enough time to provide withholding agents with sufficient notice of their compliance status.	An FFI Agreement entered into before January 1, 2014 has an effective date of January 1, 2014, while all other FFI Agreements are effective when entered into. The delayed effective date of an FFI Agreement under the Announcement (January 1, 2014 instead of July 1, 2013) is significant because the due diligence deadlines listed below are based on the effective date of the FFI Agreement. The Announcement does not address whether FFIs must enter into an FFI Agreement by June 30, 2013 to guarantee no withholding on payments made to them when withholding goes into effect on January 1, 2014.
Deadline for Implementing Due Diligence Procedures for New Obligations	By the later of July 1, 2013 or the effective date of the FFI Agreement.	By the later of January 1, 2014 or the effective date of the FFI Agreement.
Deadline for Documenting Payees of Preexisting Obligations, That Are Prima Facie FFIs	By the later of June 30, 2014 or one year after the effective date of the FFI Agreement.	By the later of June 30, 2014 or six months after the effective date of the FFI Agreement.
Deadline for Documenting Payees and Account Holders of Preexisting Obligations, That Are Entities Other than Prima Facie FFIs	By the later of June 30, 2015 or two years after the effective date of the FFI Agreement.	By the later of December 31, 2015 or two years after the effective date of the FFI Agreement.
Deadline for Documenting Pre-existing High-Value Individual Accounts	By the later of June 30, 2014 or one year after the effective date of the FFI Agreement.	By the later of December 31, 2014 or one year after the effective date of the FFI Agreement.

Deadline for Documenting Pre-existing Individual Accounts Other than High-Value Accounts	By the later of June 30, 2015 or two years after the effective date of the FFI Agreement.	By the later of December 31, 2015 or two years after the effective date of the FFI Agreement.
--	---	---

The Proposed Regulations also require withholding agents, aside from participating FFIs (e.g., US withholding agents), to complete certain due diligence procedures by specified deadlines to determine whether their payees are nonparticipating FFIs subject to FATCA withholding. The diligence deadline depends on certain factors, described below.

- Under the Proposed Regulations, accounts, instruments, or contracts executed on or after a specified date were treated as “new obligations.” The Proposed Regulations require withholding agents, aside from participating FFIs, to establish certain due diligence procedures as of the specified date to document new obligations. Obligations that are not new obligations are “pre-existing obligations.”
- The Proposed Regulations provide different diligence deadlines for documenting payees of pre-existing obligations that are (i) “prima facie FFIs” (defined above) and (ii) entities other than prima facie FFIs.

The Announcement’s due diligence deadlines similarly depend on the factors described above, but the Announcement changes the actual deadlines. The following chart compares the deadlines applicable to withholding agents other than participating FFIs under the Proposed Regulations and the Announcement.

Withholding Agents Other than Participating FFIs	Proposed Regulations (Prior Rules)	Announcement 2012-42 (New Rules)
Deadline for Implementing Due Diligence Procedures for New Obligations	By January 1, 2013	By January 1, 2014
Deadline for Documenting Payees of Preexisting Obligations, That Are Prima Facie FFIs	By December 31, 2013	By June 30, 2014
Deadline for Documenting Payees of Preexisting Obligations, Other than Prima Facie FFIs	By December 31, 2014	By December 31, 2015

The deadlines listed above contained in the Announcement provide participating FFIs and other withholding agents with a reasonable period of time to document pre-existing obligations. However, once participating FFIs and other withholding agents document an obligation (even if in advance of the applicable deadline), they must begin to withhold or report with respect to that obligation at that point, as appropriate.

In addition, unlike the Proposed Regulations, the diligence deadlines provided in the Announcement are aligned with the deadlines provided under the model intergovernmental agreements. This alignment of deadlines should enable global financial institutions more easily to implement uniform due diligence procedures for all their affiliates.

Other Deadlines

Under the Proposed Regulations, participating FFIs generally are required to report information to the IRS about their US accounts by March 31 following the calendar year to which the reporting relates. The

Proposed Regulations provide a special rule for calendar year 2013 (the first year FATCA reporting is effective), under which participating FFIs are not required to report until September 30, 2014 (although the reporting applies to all US accounts identified as of June 30, 2014). Under the Announcement, participating FFIs are not required to report with respect to the 2013 and 2014 calendar years until March 31, 2015.

The Announcement also delays withholding on certain types of withholdable payments. Withholdable payments, as noted above, include (i) US-source interest, dividends, wages and similar (fixed and determinable annual or periodical) payments (FDAP payments), and (ii) gross proceeds from the sale or other disposition of property that can produce US-source interest or dividends (gross proceeds). Under the Proposed Regulations, withholding agents are required to withhold on FDAP payments beginning on January 1, 2014, and payments of gross proceeds beginning on January 1, 2015. The Announcement delays the withholding on gross proceeds until January 1, 2017 **but does not extend the deadline with respect to withholding on FDAP payments.**

Grandfathered Obligations

Under the Proposed Regulations, an “obligation” outstanding on January 1, 2013, or any gross proceeds from the disposition of such an obligation, is not subject to withholding (i.e., is a “grandfathered obligation”). The term “obligation” generally means a legal agreement that produces or could produce a withholdable payment or foreign passthru payment, but does not include (i) stock or other equity interests, or (ii) agreements that lack a definitive expiration.

The Announcement provides the following three provisions, designed to expand and clarify the scope of grandfathered obligations.

- The scope of grandfathered obligations under the Proposed Regulations is unclear given that the Proposed Regulations do not define the term “foreign passthru payments.” As noted above, the term generally means payments attributable to a withholdable payment, but under the Proposed Regulations, the IRS is still considering rules for when a payment will be treated as so attributable. To address this uncertainty, the Announcement provides that an obligation that produces or could produce a “foreign passthru payment,” and that cannot produce a withholdable payment, will be treated as a grandfathered obligation provided the obligation is outstanding six months after the final regulations defining the term “foreign passthru payment” are filed.
- Under Section 871(m) of the Code, certain payments (dividend equivalents) specified in the statute and/or applicable proposed regulations that are determined by reference to the payment of US-source dividends are treated as US-source dividends and, as such, may be subject to FATCA withholding. The proposed regulations under Section 871(m) are not expected to be finalized until January 1, 2014. Thus, the scope of “dividend equivalents” currently is uncertain. To address this uncertainty, the Announcement provides that a grandfathered obligation will include any instrument that gives rise to a withholdable payment solely because the instrument is treated as giving rise to a dividend equivalent under Section 871(m) and the regulations thereunder, provided the instrument is outstanding six months after such instrument is first treated as giving rise to a dividend equivalent. Accordingly, instruments that give rise to dividend equivalents under applicable Section 871(m) proposed regulations (as opposed to under the statute itself) will be grandfathered, assuming they are outstanding six months after the regulations are finalized. Presumably, however, instruments that give rise to dividend equivalents under Section 871(m) itself (i.e., the statute, rather than proposed regulations) are subject to the general grandfathering rule and, as such, are required to be outstanding on January 1, 2013 in order to qualify as a grandfathered obligation.
- The Announcement expands the scope of “grandfathered obligations” to include an obligation to make a payment with respect to collateral posted to secure obligations under a notional principal contract, provided the notional principal contract is itself a grandfathered obligation.

For more information, please contact any member of Kaye Scholer's [Tax Practice](#).

Chicago
+1.312.583.2300

Los Angeles
+1.310.788.1000

Shanghai
+86.21.2208.3600

Frankfurt
+49.69.25494.0

New York
+1.212.836.8000

Washington, DC
+1.202.682.3500

London
+44.20.7105.0500

Palo Alto
+1.650.319.4500

West Palm Beach
+1.561.802.3230

Copyright ©2012 by Kaye Scholer LLP, 425 Park Avenue, New York, NY 10022-3598. All rights reserved. This publication is intended as a general guide only. It does not contain a general legal analysis or constitute an opinion of Kaye Scholer LLP or any member of the firm on the legal issues described. It is recommended that readers not rely on this general guide but that professional advice be sought in connection with individual matters. Attorney Advertising: Prior results do not guarantee future outcomes.