

Phased-in Implementation of FATCA: IRS Provides Relief to Foreign Financial Institutions

On July 14, 2011, the Internal Revenue Service (IRS) issued Notice 2011-53 (the Notice), which provides a revised timeline for the implementation of the withholding and reporting provisions of the Foreign Account Tax Compliance Act (FATCA).¹ FATCA created a withholding and reporting regime that requires foreign institutions to provide the IRS with information regarding their US customers, or be subject to withholding on all payments of certain US-source income such foreign institutions receive effective January 1, 2013. The Notice delays the effective date of the implementation of FATCA and describes certain substantive and procedural matters that will be addressed more fully in forthcoming regulations. This Advisory outlines the key aspects of the Notice.

FATCA Background

FATCA, which was included in the Hiring Incentives to Restore Employment Act of 2010 (HIRE Act), enacted on March 18, 2010, is part of an ongoing effort to combat offshore tax evasion by US persons. FATCA establishes a withholding and reporting system that requires foreign financial institutions (FFIs) and nonfinancial foreign entities (NFFE) to report certain information regarding US ownership of foreign accounts and foreign entities, or be subject to a 30 percent withholding tax on all payments the FFI or NFFE receives of certain US-source income.

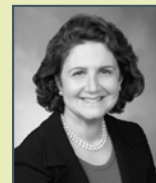
Prior to the issuance of the Notice, FATCA required FFIs (such as banks, financial intermediaries, or investment funds) to enter into an agreement with the IRS (an FFI Agreement) effective January 1, 2013, which agreement would require the FFI to: (1) identify US accounts, (2) report certain information regarding the US accounts to the IRS, and (3) withhold 30 percent tax on “pass-thru payments” made to other, nonparticipating FFIs or accountholders unwilling to provide requested information (“recalcitrant accounts”). If an FFI did not enter into an FFI Agreement, all “withholdable payments” to the FFI would be subject to 30 percent withholding. For these purposes, “withholdable payments” include certain US source income (such as interest, dividends, rents, compensation, or annuities) and any gross proceeds from the sale or other disposition of any property of

¹ Notice 2011-53, which will be published in I.R.B. 2011-32 (Aug. 8, 2011), is available at: <http://www.irs.gov/pub/irs-drop/n-11-53.pdf>.

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a type that can produce US-source interest or dividends. Similarly, NFFEs (consisting of most nonfinancial foreign institutions) would generally be required to report certain information to the IRS regarding payees; if the NFFE did not report such information, withholdable payments to the NFFE on behalf of the beneficial owner would be subject to 30 percent withholding.

The IRS has issued two prior notices concerning FATCA. In Notice 2010-60 (August 27, 2010) and Notice 2011-34 (April 8, 2011), the IRS set forth guidance regarding the operation of the new reporting and withholding regime, including elaborate procedures that participating FFIs will be expected to follow to identify US accounts among their existing accounts.²

FATCA Transitional Relief: Notice 2011-53

The Notice provides FFIs and US withholding agents with a revised timeline to implement FATCA withholding and reporting provisions, and lists certain substantive and procedural matters that will be addressed in forthcoming regulations.

The Department of the Treasury's (Treasury) and the IRS' decision to extend the implementation timeline was driven by the recognition that the obligations under FATCA require significant modifications of the information management systems of FFIs, withholding agents, and the IRS. In a complementary news release, IRS Commissioner Doug Shulman reiterated the importance of FATCA to combating offshore noncompliance and the need to ensure a smooth and timely roll-out of the new regime.³

Implementation Timeline. The Notice provides for the following key changes in the implementation timeline:

- The IRS will begin accepting FFI applications through an electronic submissions process no later than January 1, 2013.
- An FFI must enter into an FFI Agreement with the IRS by June 30, 2013 to ensure that the FFI will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014. FFIs that enter into FFI Agreements after June 30, 2013, but before January 1, 2014, will be participating FFIs with respect to 2014, but may not be identified as such in time to prevent withholding beginning on January 1, 2014.
- FATCA withholding will be implemented in two phases. First, for payments made on or after January 1, 2014, withholding will be required only on US-source interest, dividends, and other fixed or determinable annual or periodical gains, profits, and income (FDAP). Second, for payments made on or after January 1, 2015, withholding will be required both on US-source FDAP and on all other gross withholdable payments (such as gross proceeds). The obligation of participating FFIs to withhold on "pass-thru payments," which will be described in future regulations, will not begin before January 1, 2015 and the obligation of participating FFIs to compute and publish their "pass-thru payment percentages" will not begin before the first calendar quarter of 2014.
- Participating FFIs will be required to undertake due diligence to identify new and pre-existing US accounts (including certain "high-risk accounts") starting in 2013. "High-risk accounts" include private banking accounts with a balance that is equal to or greater than US\$500,000. In 2014, FFIs will be required to begin reporting to the IRS accounts identified as US accounts.

Timeline for Published Guidance. Treasury and the IRS anticipate the issuance of proposed regulations incorporating the current FATCA guidance and providing further guidance on implementing FATCA by December 31, 2011. After an opportunity for comments, Treasury and the IRS anticipate that final regulations will be published in

² Notice 2011-34, 2011-19 I.R.B. 765 (published on May 9, 2011), available at: http://www.irs.gov/irb/2011-19_IRB/ar09.html; Notice 2010-60, 2010-37 I.R.B. 329 (published on September 13, 2010), available at: http://www.irs.gov/irb/2010-37_IRB/ar06.html.

³ Treasury and IRS Issue Guidance Outlining Phased Implementation of FATCA Beginning in 2013, IR-2011-76 (July 14, 2011), available at: <http://www.irs.gov/newsroom/article/0,,id=242164,00.html>.

the summer of 2012. Treasury and the IRS also anticipate the issuance of draft final versions of the associated FFI Agreement and reporting forms for use by withholding agents and participating FFIs in the summer of 2012.

Clarification of the Scope of Grandfathered Provisions.

FATCA provisions do not apply to obligations outstanding on March 18, 2012. In earlier guidance, the Treasury and the IRS indicated that this grandfather provision applied only to legal agreements (other than instruments treated as equities for US tax purposes) with a definitive term or expiration that produce or could produce US-source withholdable payments. However, it was unclear whether the grandfather provision extended to legal agreements that give rise to “pass-thru payments” other than withholdable payments. The Notice clarifies that the grandfather provision does apply to any legal agreement with a definitive term or expiration that gives rise to such “pass-thru payments” and does not involve instruments treated as equities for US tax purposes. Therefore, it is now clear that “pass-thru payments” received by FFIs from other financial institutions, which themselves have US-source income from direct investments in the United States, are exempted from FATCA so long as the remaining requirements for grandfather treatment are satisfied.

If you have any questions about any of the topics discussed in this advisory, please contact your Arnold & Porter attorney or any of the following attorneys:

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