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Proposed FATCA Regulations Feature InterGovernmental Approach

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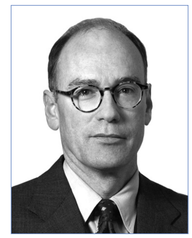

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Sections 1471 through 1474, commonly referred to as the Foreign Account Tax Compliance Act (FATCA) were originally enacted as a part of the Hiring Incentives to Restore Employment Act on 3/18/10. FATCA requires foreign financial institutions to enter into reporting agreements with the US with respect to their US account holders or be subject to a new 30% withholding tax imposed on certain US source payments. This new withholding tax generally applies to US source payments of interest, dividends, and other fixed income, as well as gross proceeds from the sale or other disposition of property of a type that can produce interest or dividends from US sources. FATCA also applies to certain "passthru payments" made by a foreign financial institution that are US source payments or that are deemed attributable to the foreign financial institution's US assets.

After a series of Notices issued by the Service and the Treasury that provided preliminary guidance with respect to FATCA,[1] the Service and the Treasury released proposed FATCA regulations in February 2012 (the Proposed Regulations).[2] The Proposed Regulations incorporate, refine, and modify prior FATCA guidance, as well as provide guidance on topics not previously addressed.

In connection with the issuance of the Proposed Regulations, the Treasury issued a Joint Statement from the United States, France, Germany, Italy, Spain, and the United Kingdom (the Joint Statement),[3] setting forth the framework for an intergovernmental approach to FATCA implementation in lieu of requiring foreign financial institutions established in those countries to report FATCA information on their US account holders directly to the Service. The Joint Statement addresses concerns raised by governments, financial institutions, and practitioners that FATCA reporting may violate various foreign privacy and data protection laws.

Proposed regulations under the Foreign Account Tax Compliance Act explain the reporting and withholding requirements applicable to foreign financial institutions with respect to their US account holders.

FATCA reporting requirements may conflict with foreign laws

FATCA generally would require foreign financial institutions (FFIs) that enter into a reporting agreement with the Service to report to the Service certain information with respect to accounts owned by US persons and by non-US entities that have significant US ownership. Under FATCA, if the local laws governing an FFI would prohibit the FFI from reporting such information to the Service,

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1. See Notice 2011-53, 2011-32 IRB 124; Notice 2011-34, 2011-19 IRB 765; Notice 2010-60, 2010-2 CB 329.
2. REG-121647-10, 2/15/12.
3. http://www.treasury.gov/press-center/press-releases/documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf.

the FFI is required to obtain a waiver of the local law restriction from the account holder or to close the account if no such waiver is obtained. The Treasury has acknowledged that FFIs established in many jurisdictions may not be able to comply with FATCA reporting, withholding, and account closure requirements as a result of legal restrictions. If a non-US law restricts an FFI from disclosing confidential information associated with an account and precludes the FFI from closing the account, such law ultimately disables the FFI from complying with FATCA.

FATCA reporting and withholding apply to payments that are made to FFIs.

For example, European data protection law may prevent FFIs from complying with FATCA disclosure requirements. The European Data Protection Directive (the EU Directive) generally does not permit the transfer of personal data outside of the European Union to third countries unless the country to which the data would be transferred is deemed to have adequate data protection. The US is not considered to have adequate data protection for these purposes. When countries do not have adequate data protection laws, the transfer of personal data may take place only if an applicable exemption to the EU Directive applies, including if the FFI obtains the consent of the account holder or if the Treasury agrees to abide by the principles of European data protection law.[4] These exceptions generally are monitored and enforced by the local data protection authorities in each EU member state, as required by the EU Directive and applicable national law.

In addition to data protection laws, European privacy laws, banking secrecy rules, and general principles of contract and fiduciary duties all may conflict with FATCA reporting requirements imposed on financial institutions. Further, various non-US jurisdictions prohibit financial institutions from withholding funds from a client's account without the holder's consent, unless a court or legal order is issued. Finally, a number of jurisdictions prohibit the unilateral closing of financial accounts.

4. For example, the EU/Swiss-U.S. Safe Harbor program permits an individual or legal entity to certify that such individual or entity will abide by the principles of European data protection law. This is a self-certification program.

To address these and other non-US legal restrictions that conflict with FATCA, the Treasury has agreed to pursue an "intergovernmental approach" to FATCA implementation to address the non-US. legal impediments to compliance, simplify practical implementation, and reduce costs for financial institutions.

Joint Statement for an intergovernmental approach. The Treasury and the Service, in consultation with foreign governments, have considered an alternative approach to FATCA, whereby certain conflicts of laws can be avoided in cases in which the foreign government provides the US with the information required to be reported under FATCA through an exchange of information agreement. In the Joint Statement, issued on 2/8/12, the United States, France, Germany, Italy, Spain, and the United Kingdom agreed to explore such an intergovernmental approach to FATCA implementation. It has also been reported that the Treasury is in discussions with other countries, including Japan and China, to finalize similar agreements. Because the policy objective of FATCA is to achieve reporting with respect to foreign accounts maintained by US persons, and not to collect an additional US withholding tax, the Treasury has indicated it is open to adopting this intergovernmental approach to implement FATCA and improve international tax compliance.

The Joint Statement describes a framework for an agreement to implement FATCA between the US and an applicable foreign country. Under this framework and subject to the terms negotiated in each specific agreement, the applicable foreign country would agree to (1) pursue the necessary implementing legislation to require financial institutions located in such foreign country (that, absent the bilateral agreement between the US and such country, would be required to enter into a FATCA reporting agreement) to collect and report to the authorities of the foreign country the information required under FATCA, (2) permit financial institutions in such foreign country to apply the necessary FATCA due diligence to identify their US account holders pursuant to the laws of such country, and then (3) transfer the FATCA-related information reported to such foreign country by its financial institutions to the US. This approach would allow the Service to take the position that each financial institution established in the applicable foreign country is FATCA compliant and not required to enter into an agreement directly with the Service to avoid FATCA withholding. However, each financial institution in such country generally would still be required to register with the Service, which likely would require the financial institution to apply for a FATCA identification number through an online process.

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In addition, the Joint Statement provides that the US will commit to reciprocity with respect to collecting and automatically reporting to the authorities of the applicable foreign country information with respect to the US accounts of the foreign country's residents. It is not clear from the Joint Statement the extent to which the US will agree to provide reciprocal information to foreign countries, although any such commitment to reciprocity would seem to require future revisions to US law. Current US reporting requirements would not seem to provide the Treasury or the Service with information comparable to the type of information the US would require under FATCA. Although US financial institutions and brokers are required to report to the Service certain information with respect to payments of interest, dividends, and proceeds on a sale or exchange of an instrument, the current US reporting requirements do not apply to payments made to corporations, foreign persons, or other exempt recipients. For those persons for whom there is a current US reporting obligation, the scope of information required to be reported to the Service falls well short of the type of information covered by FATCA reporting.

The Joint Statement also provides that the US and an applicable foreign country will work to develop a practical alternative to passthru payment withholding that minimizes the administrative burden on financial institutions established in such foreign countries. Accordingly, FFIs established in each applicable foreign country would not be required to impose FATCA withholding on passthru payments made to other FFIs organized in the same country or in another country with which the US has a FATCA implementation agreement.[5]

Many questions and challenges still remain in connection with the FATCA implementation framework set forth in the Joint Statement. For instance, it is unlikely that the US would be able to negotiate and finalize FATCA implementation agreements with each applicable foreign country prior to 1/1/13 (the expected date on which FFIs will be encouraged to begin the process of entering into FATCA reporting agreements with the Service) Also, many other countries besides the countries issuing the Joint Statement will likely seek similar arrangements with the US. The US would be expected to welcome participation by additional countries in such arrangements. In addition, it remains unclear whether an agreement between the US and an applicable foreign country would solve all potential conflicts of law issues arising in a specific jurisdiction. For example, consideration will need to be given as to whether a FATCA implementation agreement entered into between the US and an EU member country would satisfy the current data protection, privacy, and other laws of the European Union and the individual EU member countries. However, potential conflicts may become less of a concern. The European Commission has recently issued a statement in support of the intergovernmental approach taken in the Joint Statement, and may have already begun the process of amending certain restrictions that potentially conflict with the approach described in the Joint Statement with respect to FATCA.

How FATCA and the proposed regulations apply to FFIs

For FFIs that are not established in countries that enter into bilateral agreements with the US, the provisions of FATCA and the regulations promulgated thereunder would apply. FATCA establishes a new US information reporting regime that requires FFIs to identify their US accounts (which include accounts held by US persons and foreign entities with substantial US owners) and enter into an agreement (an FFI Agreement) with the Service to report specific information about their US account holders. For any FFI that is subject to FATCA, unless the FFI enters into an FFI Agreement with the Service, FATCA would impose a 30% withholding tax on all "withholdable payments" made to the FFI.

A withholdable payment generally includes US source payments of interest, dividends, rents, compensation, and other fixed income, as well as the gross proceeds from the sale or other disposition of property of a type that can produce interest or dividends from US sources (e.g., repayments of principal on a loan). However, payments made on certain short-term obligations and payments that are treated as connected with the conduct of a trade or business within the US are excluded from the definition of withholdable payment. In addition, a withholding agent is not required to withhold on payments made to "deemed-compliant FFIs" (as discussed below) and to exempt beneficial owners (as discussed below).

The Proposed Regulations provide a phased-in approach to FATCA withholding for payments made to FFIs that have not entered into a reporting agreement and are not otherwise "deemed-compliant" or exempt from FATCA. FATCA withholding is scheduled to apply to withholdable payments that are US source dividends, interest, and other fixed income payments made on or after 1/1/14 and to

5. See below for a discussion of the passthru payment rules.

withholdable payments that are payments of US source gross proceeds made on or after 1/1/15. Passthru payments that are withholdable payments made to account holders or other FFIs that do not comply with FATCA are subject to withholding as of 1/1/14. However, "foreign passthru payments" (generally, the portion of a payment made by an FFI that is deemed attributable to the FFI's US assets) made to account holders or other FFIs that do not comply with FATCA are subject to withholding as of 1/1/17 (although an FFI is required to report with respect to such passthru payments as of 1/1/15).[6] A limited grandfathering rule exempts from withholding certain obligations outstanding on 1/1/13 and payments of gross proceeds from the disposition of such obligations, unless such obligations are materially modified.[7]

The Service expects to begin accepting applications for FFI Agreements through an electronic submissions process on 1/1/13, and an FFI should enter into an FFI Agreement by 6/30/13 in order to ensure that the Service will be able to complete the process of registering the FFI as compliant before 1/1/14 (the first date that withholding agents are required to impose FATCA withholding).

Definition of foreign financial institution.
FATCA reporting and withholding apply to payments that are made to FFIs. FATCA and the Proposed Regulations provide that FFIs are non-US entities that fall within one of the following categories:

- *Foreign entities that are engaged in a banking or similar business.* A foreign entity is considered to be engaged in a banking or similar business if, in the ordinary course of its business, the entity engages in traditional banking activities such as accepting deposits of funds, making loans or entering into transactions with respect to other evidences of indebtedness, issuing letters of credit, providing trust or fiduciary services, financing foreign exchange transactions, entering into or disposing of finance leases or leased assets, or providing charge and credit card services. Whether a foreign entity is subject to the banking and credit laws and regulations of the US or a foreign country is relevant to, but not necessarily determinative of, whether that entity qualifies as an FFI. Such entities generally include banks, savings banks, commercial banks, savings and loan associations, thrifts, credit unions, building societies, and other cooperative banking institutions.
- *Foreign entities that hold financial assets for the account of others as a substantial portion of their business.* For this purpose, a foreign entity holds financial assets for the account of others as a "substantial portion" of its business if, in general, such entity's gross income attributable to holding financial assets equals or exceeds 20% of its gross income over the preceding three-year period. Whether a foreign entity is subject to the broker-dealer, fiduciary, or other similar laws and regulations of the US or a foreign country is relevant to, but not necessarily determinative of, whether that entity qualifies as an FFI. Such entities include broker-dealers, clearing organizations, trust companies, custodial banks, and entities acting as custodians with respect to the assets of employee benefit plans.
- *Foreign entities that are in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, notional principal contracts, insurance or annuity contracts, or any interest in such security, partnership interest, commodity, notional principal contract, insurance contract, or annuity contract.* A foreign entity is engaged prima rily in the business of investing, reinvesting, or trading if the entity's gross income attributable to such activities equals or exceeds 50% of the entity's gross income during the preceding three-year period. Such entities include mutual funds (or their foreign equivalent), funds of funds (and other similar investments), exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools, and other investment vehicles.

A foreign insurance company (or the holding company of an insurance company) that issues or is obligated to make payments with respect to certain financial accounts is treated as an FFI.

An entity that otherwise would be treated as an FFI as defined above will not be subject to FATCA if one of the following applies:

- The entity primarily acts as a holding company for subsidiaries that engage in trades or businesses, provided that no such subsidiary is a financial institution.

6. The definition of "foreign passthru payment" is reserved in the Proposed Regulations. In Notice 2011-34, the Treasury and the Service indicated that passthru payments would include withholdable payments made by an FFI and the amount of a payment that is not a withholdable payment multiplied by the "passthru payment percentage" (which, in general terms, is determined at the end of each fiscal quarter by dividing the sum of the FFI's US assets by the sum of the FFI's total assets).

7. The rule providing grandfather protection does not apply to any instrument treated as equity for US tax purposes, or to any legal agreement that lacks a definitive expiration or term (e.g., savings deposits, demand deposits, and other similar accounts). The proposed regulations clarify that a binding agreement to extend credit for a fixed term (e.g., a revolving loan facility) will be treated as an "obligation" outstanding for purposes of the grandfather provision, provided that on the issue date of the agreement, the material terms of the credit to be provided are fixed.

- The entity is a non-US start-up entity that is investing capital in assets with the intent to operate a nonfinancial business.
- The entity is in the process of liquidating its assets, or reorganizing with the intent to continue or recommence a nonfinancial business.
- The entity primarily engages in financing and hedging transactions with or for members of its expanded affiliated group that are not FFIs (and does not provide such services to non-affiliates).
- The entity qualifies as a tax-exempt organization for US federal income tax purposes.

These exceptions generally do not apply to entities that function as investment funds, such as private equity funds, venture capital funds, leveraged buyout funds, or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes.

Deemed-compliant status for certain FFIs.
FATCA provides that certain FFIs may be "deemed-compliant" by the Treasury. A deemed-compliant FFI avoids FATCA withholding without having to enter into an FFI Agreement with the Service. The Proposed Regulations identify two primary types of deemed-compliant FFIs: "registered deemed-compliant FFIs" and "certified deemed-compliant FFIs."

Registered deemed-compliant FFIs.
Under the Proposed Regulations, a registered deemed-compliant FFI is required to register with the Service and also certify to the Service that it meets the requirements of the applicable deemed-compliant category. A registered deemed-compliant entity will be issued a taxpayer identification number (an FFI-EIN) and be required to renew its certification to the Service every three years (or earlier if there was a change in circumstance). The Proposed Regulations provide that a withholding agent generally may treat a financial institution as a registered deemed-compliant FFI if the withholding agent has a valid withholding certificate identifying the financial institution as a registered deemed-compliant FFI and the withholding certificate contains an FFI-EIN that is verified by the withholding agent against a list that will be published and updated by the Service.[8] The Proposed Regulations list the following categories of registered deemed-compliant FFIs:

Local FFIs. To qualify as a registered deemed-compliant "local FFI," the financial institution generally must be licensed and regulated as a bank (or similar organization), a securities broker or dealer, or a financial planner or investment advisor under the laws of the country of its organization. A local FFI may not have a fixed place of business outside its country of organization nor solicit account holders outside its country of organization. For this purpose, an FFI will not be considered to have solicited account holders outside its country of organization merely because it operates a website, provided that the website does not state that nonresidents may hold deposit accounts with the FFI, does not advertise the availability of US dollar-denominated deposit accounts, or does not otherwise target US customers. At least 98% of the accounts maintained by the local FFI must be held by residents of the country in which the financial institution is organized,[9] and the laws of the country in which the local FFI is organized must require the financial institution either to report to the taxing authorities of such country information with respect to the income earned in the accounts or to impose a withholding tax with respect to accounts held by such residents. In addition, the local FFI must implement policies and procedures intended to (1) identify and close preexisting US accounts or accounts maintained by FFIs that do not enter into FFI Agreements with the Service (or, rather than close such accounts, agree to withhold and report with respect to such accounts) and (2) ensure that the local FFI does not open accounts maintained by US persons.

If a financial institution is a member of an expanded affiliated group, in order to qualify as a local FFI, each member of the expanded affiliated group must be organized in the same country and must meet the requirements applicable to local FFIs.

Nonreporting members of affiliated groups. An FFI that is a member of an affiliated group that includes one or more FFI members that have entered into FFI Agreements with the Service may register as deemed-compliant without being required to enter into an FFI Agreement with the Service or comply with FATCA reporting. In order to so qualify, the nonreporting FFI must review its existing

8. Although additional guidance will be forthcoming, FFIs that are organized in jurisdictions that enter into bilateral agreements with the US as an alternative approach to FATCA compliance likely will be required to register with the Service by undertaking procedures similar to the procedures set forth in the Proposed Regulations for registered deemed compliant financial institutions.

9. The Proposed Regulations provide that an FFI organized in an EU member state may treat account holders that are residents (including corporate residents) of other EU member states as residents of the country in which the FFI is organized for purposes of satisfying the requirement that at least 98% of the accounts must be maintained by local residents.

accounts and if any such accounts are identified as US accounts or accounts of FFIs that have not entered into an FFI Agreement with the Service, the nonreporting FFI must (within 90 days after identification) transfer the account to an affiliate that has entered into an FFI Agreement with the Service or that is a US financial institution, or close the account. The nonreporting FFI must adopt policies and procedures to ensure that existing accounts and new accounts that are or, due to a change in circumstances, become US accounts or accounts held by FFIs that do not enter into FFI Agreements with the Service are transferred to an affiliate FFI that is party to an FFI Agreement with the Service or that is a US financial institution, or that such accounts are closed.

Collective investment vehicles and restricted funds. A collective investment vehicle may be a registered deemed-compliant financial institution if it qualifies as an FFI solely because it is engaged in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or certain contracts, and is not otherwise engaged in activity that would result in it being treated as an FFI (e.g., it is not a bank or a broker). The collective investment vehicle must be regulated in its country of organization as an investment fund, and each holder of equity interests (or direct debt interests in the collective investment vehicle in excess of $50,000) and each holder of a financial account with the collective investment vehicle generally must comply with FATCA reporting or qualify for an exception.

Certain funds may also qualify as registered deemed-compliant FFIs if they are "restricted funds." Similar to collective investment vehicles, a restricted fund must be treated as an FFI solely because it is engaged in the business of investing, reinvesting, or trading, and must be regulated as an investment fund under the laws of its country of organization (although, for these purposes, the country of organization must be compliant with international policies concerning money laundering and terrorist financing). In addition, interests in the restricted fund may be sold only through certain underwriters, brokers, dealers, or other distributors of securities,[10] or redeemed directly by the restricted fund. The restricted fund must ensure that each distribution agreement prohibits the sale of its debt or equity interests to (1) US persons, (2) FFIs that do not enter into an FFI Agreement with the Service, and (3) certain other entities with substantial US owners, and each such distribution agreement requires the distributor to notify the restricted fund of any change in circumstances as to its status under FATCA. Restricted funds generally must review their preexisting direct accounts to identify any prohibited US accounts or accounts held by FFIs that have not entered into FFI Agreements with the Service. Restricted funds also are required to implement policies and procedures on a going-forward basis to identify any prohibited US accounts or accounts held by FFIs that have not entered into FFI Agreements with the Service. If such accounts are identified, the restricted fund must either close such account or withhold and report on such account as if it entered into an FFI Agreement with the Service.

Certified deemed-compliant FFIs.

A second category of deemed-compliant financial institutions provided for in the Proposed Regulations is referred to as "certified" deemed-compliant FFIs. Certified deemed-compliant FFIs will not be required to register with the Service, but will be required to certify that they satisfy the requirements for deemed-compliant status by providing specific documentation to the relevant withholding agent. The Proposed Regulations list the following categories of certified deemed-compliant FFIs:

Nonregistering local banks. A "nonregistering local bank" must be licensed and operate as a bank solely in its country of organization. In addition, a nonregistering local bank must engage primarily in the business of making loans and taking deposits from unrelated retail customers. A nonregistering local bank may not have a fixed place of business outside its country of organization, nor solicit account holders outside its country of organization. The nonregistering local bank must have no more than $175 million in assets on its balance sheet, and in general, the laws of the country in which the nonregistering local bank is organized must require it to either report information or withhold tax with respect to the income earned in such accounts. If the nonregistering local bank is a member of an expanded affiliated group, in order to qualify as a nonregistering local bank, each member of the expanded affiliated group must be organized in the same country and must meet the requirements applicable to nonregistering local banks.

A withholding agent may treat an FFI as a deemed-compliant nonregistering local bank if the withholding agent can reliably associate the payment with a valid withholding certificate that identifies the payee as a non-US entity that is a nonregistering local

10. The Proposed Regulations provide that each distributor must be an FFI that has entered into an FFI Agreement with the Service, a registered deemed-compliant FFI, a nonregistering local bank (discussed below), or a "restricted distributor." A restricted distributor, among other requirements, must operate solely in its country of organization and have no fixed place of business outside that country.

bank and that contains a certification by the nonregistering local bank that it meets the applicable requirements. Additionally, the withholding agent must receive either a current audited financial statementor, if the FFI does not have an audited financial statement, an unaudited financial statement (or other similar financial document) for the nonregistering local bank that supports its claim that it operates solely as a bank and does not otherwise contradict the certifications on the withholding certificate. A withholding agent will have reason to know that a payee is not a nonregistering local bank if the withholding agent either has knowledge that the payee operates in more than one country or can determine that the FFI has assets in excess of $175 million.

Foreign retirement funds. A foreign retirement fund qualifies as a deemed-compliant retirement fund in one of two ways. First, a foreign retirement fund qualifies if it satisfies the following three criteria: (1) all contributions (other than a transfer of assets from otherwise exempted retirement accounts or plans) to the retirement fund are employer, government, or employee contributions that are limited by reference to earned income; (2) no single beneficiary of the fund has a right to more than 5% of the retirement fund's assets; and (3) contributions to the retirement fund are deductible or excluded from the gross income of the beneficiary under the tax laws of the jurisdiction in which the retirement fund is established or operates, taxation of the investment income in the retirement fund that is attributable to the beneficiary is deferred under such laws, or 50% or more of the total contributions to the fund (other than transfers of assets from otherwise exempted accounts or plans) is from the government and the employer.

Alternatively, certain small retirement funds may qualify as certified deemed-compliant if the retirement fund has fewer than 20 participants, the fund is sponsored by an employer that is engaged in an active trade or business, and contributions are limited by reference to earned income. Additionally, participants who are not residents of the country in which the retirement fund is organized must (in the aggregate) not be entitled to more than 20% of the retirement fund's assets, and no such participant may be entitled to more than $250,000 of the fund's assets.

A withholding agent may treat a retirement fund as a certified deemed-compliant retirement fund if the withholding agent can associate the payment with a valid withholding certificate in which the retirement fund certifies that it meets one of the sets of requirements outlined above and the withholding agent has an organizational document associated with the fund that generally supports its claim (e.g., the organizational document indicates that the fund qualifies as a retirement plan under the laws of the jurisdiction in which it was organized).

Nonprofit organizations. A nonprofit organization may also qualify as a deemed-compliant organization if the organization is established and maintained in its country of residence exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes, and is exempt from income tax in its country of residence. In addition, the nonprofit organization generally must prohibit the distribution of any assets or income in a manner that would be treated as private inurement (i.e., for the benefit of any private person or non-charitable organization) and all assets must be distributed to governmental entities or to other deemed compliant nonprofit organizations upon liquidation or dissolution.

A withholding agent may treat a nonprofit organization as deemed-compliant if the withholding agent can associate the payment with a valid withholding certificate that identifies the organization as meeting the requirements discussed above and the organization has provided a letter from counsel concluding that such requirements have been met.

FFIs with only low-value accounts. A final category of certified deemed-compliant financial institutions consists of financial institutions with only low-value accounts. To qualify as a low-value account financial institution, a financial institution must either accept deposits in the ordinary course of a banking or similar business or hold, as a substantial portion of its business, financial assets for the accounts of others. In addition, the financial institution must not maintain any financial account with a balance or value greater than $50,000 and must not have more than $50 million in assets on its balance sheet (or combined balance sheet for an expanded affiliated group) at the end of its most recent year.

A withholding agent may treat a low-value account financial institution as deemed-compliant if the withholding agent can reliably associate the payment with a valid withholding certificate that identifies the financial institution as such and an organizational document that supports the financial institution's claim that it meets the requirements outlined above. In addition, the withholding agent must have a current audited financial statement (or if unavailable, an unaudited financial statement or similar financial document) for the financial institution and all members of its expanded affiliated group that supports the claim that the entity (or group) does not have more than $50 million in assets.

Exempt beneficial owners.
The Proposed Regulations provide that a withholding agent is not required to withhold on a withholdable payment to the extent that the withholding agent can associate the payment as attributable to an "exempt beneficial owner." For these purposes, exempt beneficial owners include (1) foreign governments, political subdivisions thereof, and wholly owned agencies or instrumentalities of a foreign government; (2) international organizations and wholly owned agencies or instrumentalities thereof; (3) foreign central banks of issue; (4) governments of US territories; and (5) certain foreign retirement plans. Although payments beneficially owned by these persons may be exempt from withholding under FATCA, exempt beneficial owners are required to provide withholding agents with certain documentation to establish that they qualify for this exemption.

For example, there are two types of retirement funds eligible for an exemption from FATCA withholding because they may be treated as exempt beneficial owners: (1) retirement funds that are established in a country with which the US has an income tax treaty and (2) employer-sponsored retirement funds.

Under the first category, a retirement fund is an exempt beneficial owner if it (1) is eligible for the benefits of an income tax treaty with the US with respect to income the fund derives from US sources, (2) generally is exempt from income tax in its country of organization, and (3) operates principally to administer or provide pension or retirement benefits. Under the second category, a retirement fund that is not entitled to the benefits of an income tax treaty would still be an exempt beneficial owner as a retirement fund if it generally satisfies all the requirements for a certified deemed-compliant retirement fund described above.

For a relevant withholding agent to determine that a withholdable payment (or portion thereof) is allocable to an exempt retirement fund, the retirement fund is required to provide the withholding agent with (1) a certificate in which the retirement fund certifies that it is a retirement fund meeting the requirements of the exempt beneficial ownership rules, and (2) either a withholding certificate that makes a valid claim for treaty benefits under the pension plan article of an income tax treaty or an organizational document associated with the retirement fund that generally supports the fund's claim that it satisfies the requirements described above.

Reporting under FATCA: entering into an FFI agreement with the Service

To avoid the 30% withholding tax, FATCA requires an FFI to enter into an FFI Agreement with the Service under which the financial institution agrees to:

- Obtain sufficient information from each account holder to determine which accounts are held by US persons or held by foreign entities with substantial US owners.
- Comply with specific due diligence procedures with respect to the identification of US-owned accounts.
- Report annually certain information with respect to any US-owned account maintained by such FFI.
- Comply with requests by the Treasury for additional information with respect to any US owned account maintained by the FFI.
- Obtain a waiver (or close the account) in any situation in which a foreign law would, but for a waiver, prevent the reporting of any information required by FATCA.
- Deduct and withhold 30% from any withholdable payment that is made by the FFI to (1) an account holder that fails to comply with requests for information by the FFI or fails to provide a waiver of any foreign law that conflicts with FATCA (a recalcitrant account holder); (2) an FFI that does not enter into an FFI Agreement with the Service; and (3) another FFI that has made an election to be withheld upon rather than withhold on any portion of the payment allocable to a recalcitrant account holder or an FFI that does not enter into an FFI Agreement with the Service.

FATCA provides that certain FFIs may be 'deemed-compliant' by the Treasury.

Definition of "US accounts."
Reporting under FATCA is required with respect to US accounts. US accounts are defined in the Proposed Regulations as any

financial accounts held by US individuals and entities[11] and financial accounts held by foreign entities with substantial US ownership.[12] The Proposed Regulations provide that financial accounts include depository accounts, custodial accounts, equity, or debt interests (other than interests that are regularly traded on an established securities market) in certain financial institutions, and cash value insurance contracts and annuity contracts. Interests as a limited partner in a partnership that is primarily engaged in the business of investing or interests in private equity and hedge funds will constitute financial accounts.

Importantly, under the Proposed Regulations, most debt and equity securities issued by banks and brokerage firms will be excluded from the definition of financial account. In addition, depository accounts of individuals with an aggregate value not exceeding $50,000 will not be treated as US accounts.

Application of FATCA to payments made by an FFI (the passthru payment rules).

FFIs that enter into FFI Agreements with the Service (participating FFIs) are required to deduct and withhold 30% on any payments made to recalcitrant account holders and other FFIs that have not entered into FFI Agreements with the Service, in each case if such payment is a withholdable payment or to the extent that such payment is deemed attributable to a withholdable payment (passthru payments).

The Proposed Regulations and the prior FATCA Notices issued by the Treasury and the Service provide that passthru payments are intended to include payments made to account holders that are deemed to be attributable to withholdable payments. In other words, a payment by a participating FFI to another FFI that does not report under FATCA may be subject to reporting and withholding to the extent that the payment by the participating FFI is deemed to be attributable to its receipt of withholdable payments. Thus, FFIs will be encouraged to enter into FFI Agreements with the Service even if such FFIs do not directly hold assets that produce withholdable payments (e.g., an FFI held assets that produced withholdable payments through a blocker corporation). Participating FFIs also will be required to calculate the percentage of their passthru payments, in general, by dividing their US assets by their total assets. As a result, a participating FFI's passthru payment percentage will take into account indirect interests in assets of a type that could give rise to withholdable payments, such as certain interests in, or financial accounts held by, "lower tier" FFIs.

Each participating FFI will be required periodically to make available its passthru payment percentage information on, for example, a website or database readily searchable by the public. The determination of when a passthru payment percentage is out-of-date and how frequently an FFI must check for more recently published passthru payment percentages of other FFIs will be set out in future guidance from the Treasury and the Service. As currently contemplated, any participating FFI that does not calculate and publish its passthru payment percentage would be required to withhold on the full amount of any passthru payments made to recalcitrant account holders and other FFIs that did not enter into an FFI Agreement with the Service. A participating FFI would not have to withhold on any portion of a passthru payment made to a deemed-compliant financial institution or other financial institution exempt from FATCA reporting.

Expanded affiliated group.

FATCA generally provides that the withholding, reporting, and other requirements imposed on an FFI will apply with respect to all FFIs that are members of the same "expanded affiliated group."[13] Under the Proposed Regulations, each FFI affiliate of an expanded affiliated group generally would have to register with the Service for any FFI affiliate to be treated as a participating FFI or a registered deemed-compliant FFI. In addition, the Proposed Regulations generally provide that for an FFI affiliate to obtain status under FATCA as a participating FFI or a deemed-compliant FFI, each such FFI affiliate generally would be required to meet the necessary FATCA requirements. The Proposed Regulations provide a two-year transition rule (until 1/1/16) for the full implementation of the expanded affiliated group rules for FFI affiliates that are located in

11. Subject to certain exceptions, U.S. accounts include financial accounts held by U.S. persons *other than* (1) publicly traded corporations (and certain affiliates of such publicly traded corporations), (2) tax exempt organizations, (3) the U.S.or a wholly owned agency or instrumentality thereof, (4) any state, the District of Columbia, any U.S.possession, any political subdivision of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing, (5) banks, (6) real estate investment trusts, (7) regulated investment companies, (8) common trust funds, (9) tax exempt trusts, (10) dealers in securities, commodities or derivative financial instruments, and (11) brokers.

12. A substantial U.S. owner is generally any U.S. person that owns (1) directly or indirectly, more than 10% of the stock of a foreign corporation (by vote or value); (2) directly or indirectly, more than 10% of the interests in a foreign partnership (by profits or capital); (3) any interest in a foreign grant or trust; or (4) more than 10% of the beneficial interests in a foreign trust, directly or indirectly. The 10% threshold does not apply to financial institutions that are primarily engaged in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interests (including a futures or forward contract or option) in such securities, partnership interests, or commodities, such as private equity funds, hedge funds, and mutual funds.

13. An "expanded affiliated group" is defined more broadly than the term "affiliated group" under current U.S. tax law. The definition of expanded affiliated group substitutes the 80% vote and value ownership test (used to determine members of an affiliated group under current law) with a 50% vote and value test and includes foreign corporations, insurance companies, and entities other than corporations (such as partnerships) .

a jurisdiction that prohibits reporting or withholding under FATCA.[14] However, the Proposed Regulations do not provide how this issue will be resolved after the two-year transitional period ends.

The preamble to the Proposed Regulations briefly discusses the registration process contemplated for expanded affiliated groups. FFI affiliates will be required to apply for participating FFI status or register for deemed-compliant FFI status through a coordinated application process. For this purpose, each FFI expanded affiliated group will designate a "lead FFI" to initiate and manage the online registration process for the entire group. The lead FFI will register itself with the Service and identify to the Service each other member of the group that will register for participating or registered deemed-compliant status. The lead FFI also will be responsible for managing the information of the FFI group. A unique FATCA identifier will be assigned to each member of the expanded affiliated group for purposes of the registration process. The Treasury and the Service expect to issue future guidance on the registration process for expanded affiliated groups.

Due diligence procedures for the collection of information and identification of persons

An FFI that has entered into a reporting agreement with the Service must determine the status of its existing account holders as well as put in place account opening procedures to identify US accounts on or after the effective date of its FFI Agreement with the Service. The due diligence procedures set forth in the Proposed Regulations distinguish between individual accounts and entity accounts and between preexisting accounts and new accounts.

Identifying individual accounts.

A participating FFI generally is required to collect an IRS Form W-8 or W-9 from each individual account holder to identify which accounts are US accounts and which accounts are not US accounts.[15] Subject to certain exceptions, a participating FFI is also required to review all information collected with respect to the opening or maintenance of each account, including documentation collected as part of the participating FFI's account opening procedures and documentation collected for other regulatory purposes to determine if an account has indicia of US status.[16]

Reduced due diligence requirements for certain preexisting individual accounts.

Notwithstanding the general due diligence requirements discussed above, under the Proposed Regulations, a participating FFI generally will not be required to treat as a US account any preexisting individual depository account with a balance or value that does not exceed $50,000 and, generally, will not be required to document such account as a US account or account held by a recalcitrant account holder. In other words, such an account generally would not be treated as a US account or an account held by a recalcitrant account holder for FATCA withholding or reporting purposes. An account that has a balance or value that does not exceed $50,000 as of the effective date of the participating FFI's FFI Agreement with the Service will be treated as meeting this exception until the account balance or value exceeds $1 million at the end of any subsequent calendar year. For purposes of calculating the $50,000 threshold, rules requiring aggregation of accounts would apply.

Accounts that are maintained outside the US with a balance or value exceeding $50,000 but not exceeding $1 million generally will be subject only to review of electronically searchable data for indicia of US status.

Enhanced due diligence requirements for high-value preexisting individual accounts.

Preexisting individual accounts that are maintained outside the US and that have a balance or value that exceeds $1 million are subject to certain "enhanced" due diligence requirements, which includes a review of non-electronic files and an inquiry as to the actual knowledge of any relationship manager associated with the account.

Identifying entity accounts.

Participating FFIs generally will be required to obtain a valid withholding certificate on IRS Form W-8 or Form W-9 from the holder of a preexisting or new account that is held by a person other than an individual (an entity account) to determine the account holder's status for FATCA purposes. A participating FFI may be able to presume the status of the account holder as foreign without obtaining certification of foreign status under certain circumstances. For instance, a participating FFI may presume the status of an

14. During this transition period, the FFI in the restrictive jurisdiction must still comply with certain due diligence procedures and certain other requirements.

15. The Service Intends to update Form W-8 to include information that is relevant to determining an account holder's status, such as including a field for an FFI-EIN number.

16. Examples of indicia of U.S. status discussed in the Preamble to the Proposed Regulations include (1) identification of an account holder as a U.S. person, (2) a U.S. place of birth, (3) a U.S. address or telephone number, (4) standing instructions to transfer funds to an account maintained in the U.S. and (5) a power of attorney or signatory authority granted to a person with a u.s. address.

account holder as foreign if the account holder has indicia of foreign status, such as an EIN that begins with the two digits "98," the account holder's communications are mailed to an address in a foreign country, the account holder has a telephone number outside of the US, or the name of the account holder indicates that it is of a type that is treated as a per se foreign cor poration under the regulations.

If no holder of a preexisting entity account that is maintained outside the US has previously been documented by the FFI as a US person and if all accounts held (in whole or in part) by such holder have a balance or value that does not exceed $250,000 (calculated under certain aggregation rules), such account will be exempt from due diligence review.

Summary of the FATCA certifications required to be made by a responsible officer.
Under the Proposed Regulations, a responsible officer of a participating FFI would be required to make written certifications to the Service related to FATCA. Specifically, the responsible officer would be required to certify to the Service the following:

- For preexisting individual accounts that have a balance or value exceeding $1 million, the responsible officer must certify, within one year after the date of the FFI Agreement, that the FFI has completed an enhanced review of all such accounts, and after conducting a reasonable inquiry, the FFI did not have any formal or informal practices or procedures in place from 8/6/11 through the date of such certification to assist account holders in the avoidance of FATCA.
- Within two years of the effective date of the FFI Agreement with the Service, the responsible officer must certify that the FFI has completed all required due diligence procedures for pre existing accounts described above.

Reporting on US accounts

FATCA generally requires each participating FFI to report the following information with respect to each US account maintained by the financial institution pursuant to its FFI Agreement with the Service:

- The name, address, and TIN of each account holder that is a US person (or each substantial US owner of any account holder that is a US-owned foreign entity).
- The account number.
- The account balance or value.
- The gross receipts and gross withdrawals or payments from the account during the calendar year.

Importantly, the reporting obligations under FATCA are in addition to any reporting obligations imposed on, or which the FFI is subject to, under current US law. Thus, an FFI that is a "qualified intermediary" will be required to report under both the qualified intermediary regime and the FATCA regime. However, the Proposed Regulations contemplate that special rules will apply with respect to certain participating FFIs to coordinate their FATCA reporting with their other reporting requirements under current US tax law.

Account number.
The Proposed Regulations provide that the account number to be reported with respect to an account is the identifying number assigned by the participating FFI to satisfy FATCA reporting or, if no account number is used by the participating FFI, a unique serial number or other number assigned to the account that is unique and will distinguish the specific account.

Reporting account balance or value.
The Proposed Regulations generally would limit the reporting obligations of participating FFIs with respect to their account balances to calendar year-end account balances or values (as opposed to monthly or quarterly account balances or values). In addition, under the Proposed Regulations, the account balance or value may be reported in US dollars or in the currency in which the account is denominated. If the FFI reports the account in US dollars, the FFI would be required to apply a spot rate that is determined as of the last day of the calendar year to translate the balance or value, or the closure date of the account if the account was closed during such calendar year.

Reporting gross receipts and withdrawals.
A participating FFI must annually report payments made with respect to a US account based on the type of US account. The Proposed Regulations provide that a participating FFI generally would be required to report (1) with respect to depository accounts, the aggregate gross amount of interest paid or credited to the account during the year; and (2) with respect to custodial accounts, the aggregate gross amount of dividends, interest, or other income paid or credited to the account during the calendar year, and the

gross proceeds from the sale or redemption of property paid or credited to the account during the calendar year with respect to which the financial institution acted as a custodian, broker, nominee, or otherwise as an agent for the account holder. For US accounts that are non-publicly traded debt and equity interests in an FFI and that are not otherwise excluded from FATCA,[17] the FFI would be required to report with respect to gross amounts paid or credited to account holders during the calendar year, including the aggregate amount of redemption payments made to account holders during the calendar year.

Under the Proposed Regulations, a participating FFI may determine the amount and characterization of these reportable payments under principles other than US federal income tax principles. For instance, the Proposed Regulations would permit the participating FFI to determine the amount and characterization of payments using the same principles that such participating FFI uses to report information on its resident account holders to the tax authorities in the jurisdiction in which it is located, or if it does not report such information to the tax authorities, the participating FFI may apply the same principles it uses to report to the account holder. If the participating FFI does not report such payments to either the tax authorities or the account holder, the FFI may apply US federal tax principles or any reasonable method of reporting that is consistent with the accounting principles generally applied by the FFI. Once a participating FFI has applied a method to determine such amounts, it must apply such method consistently for all account holders and for all subsequent years unless the Service consents to a change in such method. In addition, a participating FFI would be permitted to report any payments in the currency in which the payment is denominated or in US dollars.

Branch reporting.
FFI Agreements with the Service generally will provide that the participating FFI that maintains a US account is responsible for reporting with respect to the account for each calendar year. To alleviate concerns that local law would prevent consolidating account holder information across branches, participating FFIs may elect to have each branch report information separately regarding the US accounts it maintains.

Election to be subject to same reporting as US financial institutions.
As an alternative to the reporting requirements described above, a participating FFI may elect to be subject to the same reporting requirements as US financial institutions, whereby the participating FFI would provide the Service with information as if it were a US financial institution and as if each holder of a US account were an individual and citizen of the US. Such an election would require the FFI to file information returns such as IRS Forms 1096 and 1099.If such an election is made, however, the FFI generally must still report the name, address, and taxpayer identification number of each account holder that is a US person and each substantial US owner of any account holder that is a US-owned foreign entity; as well as the account numbers. The FFI would not be required to report (1) the account balance or value or (2) the gross receipts and gross withdrawals or payments from the account.

Phase-in of reporting requirements.
In general, the Proposed Regulations provide that the information required to be reported with respect to US accounts and accounts of recalcitrant account holders would be required to be filed electronically with the Service on or before March 31 of the year following the end of the calendar year to which the information relates. However, the Proposed Regulations provide that a participating FFI would not be required to report to the Service until 9/30/14 with respect to its US accounts and accounts of recalcitrant account holders held during the 2013 calendar year. In addition, special rules would phase in the extent of information required to be reported by participating FFIs with respect to the 2013 through 2015 calendar years. In general, for reporting in 2014 and 2015 (with respect to calendar years 2013 and 2014), participating FFIs would be required to report only the name, address, taxpayer identification number, account number, and account balance with respect to US accounts. For reporting in 2016 (with respect to calendar year 2015), income associated with US accounts also would be required to be reported, and for reporting in 2017 (with respect to calendar year 2016), information on gross proceeds from broker transactions also would be required to be reported.

17. As discussed above, under the Proposed Regulations, most debt and equity securities issued by banks and brokerage firms would be excluded from the definition of financial account.

Future guidance

The Treasury and the Service expect to issue future guidance on topics not covered in the Proposed Regulations. Such guidance includes a draft model FFI Agreement with the Service and draft forms relating to FATCA reporting, as well as future regulations that provide guidance on substantive procedural issues.

Before the FATCA withholding requirement begins on 1/1/14, it is likely that many countries will pursue the intergovernmental approach proposed under the Joint Statement and begin negotiations of FATCA implementation agreements with the US. As a result, the procedures described under the Proposed Regulations may become less of a concern for governments, financial institutions, and practitioners in many foreign countries, and the framework described in the Joint Statement could become the avenue through which information targeted by FATCA legislation will be obtained.

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