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IRS Announces New Guidance on FATCA Timelines, Gross Proceeds and Grandfathered Obligations

On October 24, 2012, the IRS issued Announcement 2012-42, presenting additional guidance for effectuating the Foreign Account Tax Compliance Act (FATCA). The new guidance, to be incorporated in the still forthcoming final regulations, sets out new deadlines for due diligence, postpones withholding on gross proceeds and defines three new categories of "grandfathered obligations."

Background

Enacted in 2010, FATCA generally requires withholding agents to withhold 30 percent of certain payments to a foreign financial institution (FFI) unless the FFI executes an agreement with the IRS to report information with respect to U.S. accounts and U.S. accountholders. The Treasury published proposed regulations under FATCA on February 15, 2012, defining key terms and instituting various deadlines for the various due diligence, documentation and withholding requirements. In July, the Treasury released model intergovernmental agreements (IGA) to facilitate compliance by FFIs in jurisdictions that might restrict the reporting required by FATCA and enlist partners in fighting international evasion. The IGA establishes distinct compliance timelines and other liberalized modifications of the proposed regulations. Under the first model IGA, FFIs would report information to their respective governments, which would exchange the information with the United States. A second model IGA would allow FFIs to report some information directly to the IRS, while other information could be obtained through intergovernmental exchange. To date, only the United Kingdom has signed an IGA (of the first model type), but the Treasury expects to conclude many more, including several by the end of 2012.

Comments to the pre-Announcement guidance advocated alignment of the timeframes for FATCA compliance under the proposed regulations and IGAs. Additionally, commenters asked that certain obligations and instruments be treated as "grandfathered" pending further guidance in the form of finalized regulations under FATCA or other parts of the Internal Revenue Code. The recent Announcement clearly reflects the IRS' attempt to respond to comments IRS received to previously issued guidance, especially in anticipation of finalized regulations slated to be issued before year end. The IRS expressly states that the final regulations will embody the modifications introduced in this latest pronouncement.

Converged (and Generally Postponed) FATCA Deadlines

The majority of the Announcement establishes compliance timelines for documentation and withholding that essentially conform to the dates set out in the IGAs. In general, all withholding agents, including participating and deemed-compliant FFIs, must implement new account opening procedures by January 1, 2014, or if later, the effective date of an FFI Agreement or the date on which an FFI registers as deemed-compliant. (Previously, this deadline was July 1, 2013, for participating FFIs.) In consideration of this new deadline, the definition of "preexisting obligation" will now include, generally, accounts, instruments or contracts maintained or executed prior to January 1, 2014, or if later, the effective date of an FFI Agreement or the date on which an FFI registers as deemed-compliant. The final regulations will provide that any FFI Agreement entered prior to January 1, 2014, will have an effective date of January 1, 2014.

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continued from front page...

The Announcement also provides transition rules for due diligence on preexisting obligations. Withholding agents, including participating FFIs, must document prima facie FFIs by June 30, 2014, or if later, the date six months after the effective date of an applicable FFI agreement (e.g. June 30, 2014, for any agreement entered on or before December 31, 2013). Accordingly, the final rules will not require FATCA withholding prior to July 1, 2014, on payments to prima facie FFIs on preexisting obligations, unless a withholding agent has documentation establishing a payee's nonparticipating FFI status. With respect to payees other than prima facie FFIs, withholding agents, including participating FFIs, must document such payees by December 31, 2015, or if later, the date two years after the effective date of an applicable FFI agreement. Starting January 1, 2016, a withholding agent would generally treat any undocumented foreign entity payee as a nonparticipating FFI (i.e., subject to FATCA withholding) unless and until appropriate documentation is obtained.

Participating FFIs must now document preexisting individual high-value accounts (i.e., greater than \$1 million) by the later of December 31, 2014, or the date one year after the effective date of an applicable FFI agreement. Participating FFIs must properly document preexisting individual accounts (other than high-value accounts) prior to the later of December 31, 2015, or the date two years after the effective date of an applicable FFI agreement. After the respective deadlines, participating FFIs must treat any preexisting account as held by a recalcitrant accountholder (i.e., subject to FATCA withholding) unless and until appropriate documentation is obtained.

Finally, the Announcement postpones the due date for the first report of a participating FFI with respect to the calendar years 2013 and 2014 to March 31, 2015 (from September 30, 2014, under the proposed regulations).

Gross Proceeds Withholding and Grandfathered Obligations

The Announcement delays withholding on gross proceeds to January 1, 2017 (from January 1, 2015), modifying the definition of "withholdable payment" to include gross proceeds from any sale or disposition occurring after December 31, 2016.

Finally, the Announcement states that the final regulations will extend the term "grandfathered obligations" to include (1) an obligation that produces foreign passthru payments, cannot produce withholdable payments and is outstanding as of the date six months after the date final regulations are filed with the Federal Register; (2) 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) of the Code and regulations thereto, provided the instrument is outstanding on the date six months after the date on which instruments of its type first become subject to such treatment; and (3) any obligation to make a payment with respect to or to repay collateral posted to secure a notional principal contract that is itself a grandfathered obligation.

Conclusion

The Announcement overall represents positive updates in FATCA guidance by conforming timelines under the regulations and the IGAs, thereby generally offering FFIs more time to implement systems necessary to comply with FATCA obligations. As FFIs enter FFI Agreements with IRS during the coming year and the Treasury negotiates more IGAs, the convergent (and delayed) timeframe should help avoid duplicative due diligence efforts that might have otherwise resulted under the proposed regulations. The two-year delay for withholding on gross proceeds and the expansion of "grandfathered obligations" under the Announcement are also welcome changes.

Nevertheless, withholding agents and FFIs should note that January 1, 2014, remains the general effective date for FATCA withholding on U.S. source "withholdable payments," and supplemental guidance to the Announcement specifies that withholding and reporting duties begin with respect to a given account immediately after its status is documented (even if the deadline for review has not yet expired). The remainder of 2012 and much of 2013 will undoubtedly see further FATCA developments, including the highly anticipated final regulations and the conclusion of many more IGAs and FFI agreements. While the Announcement eases some timing pressures, determining obligations under FATCA and implementing the procedures and systems to comply still represent tremendous efforts that should be underway already.

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