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International Tax ADVISORY ■

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Treasury Presents… More FATCA Regulations

On February 20, 2014, the U.S. Treasury and IRS released two sets of regulations relating to the Foreign Account Tax Compliance Act (FATCA). The new regulations were published in the Federal Register on March 6. Enacted by the 2010 HIRE Act, FATCA imposes a 30-percent withholding tax on certain payments to foreign financial institutions (FFIs) and passive non-financial foreign entities (NFFEs) that do not report information about their U.S. accounts and substantial U.S. owners, respectively. One set of the new regulations (T.D. 9657) modifies various provisions of the "final" FATCA regulations issued in January 2013. The other set of regulations (T.D. 9658) provides rules to coordinate the withholding and reporting regimes of Chapter 3, Chapter 61 and Section 3406 with FATCA.

Changes to Final FATCA Regulations

The latest FATCA regulations make a number of changes to the January 2013 rules. Some of these revisions were previewed in other guidance, such as Notice 2013-43 and Notice 2013-69, while others respond to suggestions and make additional clarifications. One responsive change is that "grandfathered obligations" may include life insurance contracts that allow substitution of the insured, although such substitution would constitute a material modification. Under the new regulations, withholding agents (other than the issuer or its agent) are required to treat a modification of an obligation as material only if the withholding agent has actual knowledge. A "branch" now clearly includes disregarded entities of an FFI. The new rules also clarify the "expanded affiliated group" (EAG) ownership rules as to corporate and noncorporate members and allow a noncorporate entity to be treated as common parent. An EAG now excludes preexisting "limited life debt investment entities," a term that itself is significantly expanded under the new rules.

Another key change lets certain NFFEs elect to report directly to the IRS, rather than to withholding agents, regarding their substantial U.S. owners. Such NFFEs, as well as NFFEs that are qualified intermediaries, withholding partnerships or withholding trusts under Chapter 3 are now considered excepted NFFEs under the latest regulations. A new transition rule, providing for withholding on collateral payments starting January 1, 2017, is meant to give affected stakeholders time to make appropriate system changes. The new rules also offer some reprieve to participating FFIs regarding recalcitrant accountholders—an event of default occurs only if the FFI does not reduce the number of recalcitrant accountholders as a result of noncompliance with

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due diligence requirements. FFIs will also have an automatic 90-day extension to complete the Form 8966, FATCA Report, with respect to recalcitrant accountholders.

Coordination with Chapters 3 and 61 and Section 3406

The recent regulations also deliver on the Treasury and IRS' promise to harmonize the withholding and reporting regimes of Chapter 3 (withholding for U.S. source payments to foreign persons), Chapter 61 and Section 3406 (withholding and backup withholding, respectively, for payments to certain U.S. persons) with FATCA. The key changes in these regulations attempt to reduce the aggregate burden of these separate regimes by integrating their due diligence, reporting and withholding obligations, as appropriate in light of their distinctive purposes. Technical changes conform the respective regulations to take account of the substantive modifications (e.g., updating examples, cross-references and definitions).

Important changes, made in response to comments, eliminate discrepancies between the payee identification and documentation rules of Chapter 3 and those of FATCA. The new rules also allow withholding agents to rely on certificates with foreign tax identification numbers for residents of U.S. treaty or tax information exchange partners. Considering the cumbersome process to obtain an individual taxpayer identification number, this change is quite obliging to stakeholders. Other helpful changes include extending the validity of preexisting forms beyond the imminent July 1 effective date and allowing withholding agents to rely on faxed, scanned and e-mailed certificates. The regulations also provide rules to prevent double withholding under both Chapter 3 and FATCA or both Section 3406 and FATCA.

As forecasted in Notice 2013-69, the new regulations generally relieve non-U.S. payors from Chapter 61 reporting to the extent that those non-U.S. payors report on a U.S. account pursuant to FATCA or an applicable intergovernmental agreement (IGA). The Treasury declined to provide a similar exception for U.S. payors, given the broader scope of their Chapter 61 responsibilities and its facilitation of tax compliance. (Somewhat oddly, however, no recipient copy is required for Form 8966 as for Form 1099, potentially laying a trap for some taxpayers.) However, the rules offer a limited exception to Chapter 61 reporting for both U.S. and non-U.S. payors that are FFIs reporting under FATCA or an applicable IGA with respect to presumed U.S. non-exempt payees. Another narrow exception from Chapter 61 reporting is offered for U.S. payors acting as stock transfer agents or paying agents of distributions from passive foreign investment companies (PFICs), based on suggestions to reduce redundant reporting as to PFIC shareholders.

Conclusion

Both sets of the new regulations generally seek to add clarity and reduce burden, taking into account many stakeholder concerns and recommendations. Still, as the July 1 effective date for FATCA withholding looms, stakeholders can only hope that these are indeed "the last substantial package of regulations necessary to implement [FATCA]," as the Treasury claims. (Notably, the preamble to T.D. 9657 signals areas for further guidance, including verification of sponsoring entities and changes to FFI agreements.) After the issuance of the new regulations, several critical forms and instructions were published as final, including Forms 8966, 1042, W-8BEN and W-8ECI, but others remain outstanding. The Treasury and the IRS are firm that the July 1 effective date will not be extended, but it remains to be seen whether all the pieces can come together in time.

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