

October 26, 2012

## Revisions to FATCA Implementation

*IRS announces certain new time lines for implementation and further interpretive guidance.*

On October 24, the Internal Revenue Service (IRS) announced several key revisions to Foreign Account Tax Compliance Act (FATCA)<sup>1</sup> implementation time lines and additional interpretive guidance, which will be reflected in the final FATCA regulations that are expected this fall. In Announcement 2012-42 (the Announcement),<sup>2</sup> the IRS noted that the revisions and guidance are in consideration of comments it has received that raise practical issues relating to the FATCA time lines set forth in earlier guidance, as well as uncertainty associated with pending FATCA and non-FATCA related U.S. Department of the Treasury regulations.

### Diligence Time Lines Revised; Deadline for FFI Agreement Postponed

The Announcement generally provides for an extension of time lines for foreign financial institutions (FFIs) and other withholding agents to conduct due diligence with respect to their accounts. Under model intergovernmental agreements (IGAs) between the United States and other jurisdictions, FFIs in such jurisdictions would satisfy their obligations under FATCA by conducting diligence on their accounts and reporting to their home governments, rather than to the United States; the home governments would then report information directly to the United States. The published model IGAs contain time frames for the completion of such diligence that vary from certain time frames contained in the proposed FATCA regulations. The announced revisions are intended to provide for uniform deadlines applicable to industry participants in IGA and non-IGA jurisdictions, as well as to match deadlines applicable to U.S. withholding agents making U.S. source payments with those applicable to participating FFIs. The revised time lines are briefly summarized as follows:

- **New Account Opening Procedures:** U.S. withholding agents, participating FFIs, and “registered deemed-compliant FFIs” are required to implement new account opening procedures by January 1, 2014. The deadlines were previously January 1, 2013, for U.S. withholding agents; July 1, 2013, for participating FFIs (or, if later, the effective date of the FFI agreement); and the date of registration as a deemed-compliant FFI for deemed-compliant FFIs.
- **Preexisting Entity Accounts:** The deadline for diligence with respect to preexisting accounts held by “prima facie FFIs” is now generally June 30, 2014, and the deadline for preexisting accounts held by non-prima facie FFIs is now generally December 31, 2015. These two dates are subject to extension if a participating FFI signs its FFI agreement after January 1, 2014. A “prima facie FFI” is generally defined in the proposed regulations as any payee that a withholding agent, in its records, has designated as a qualified or nonqualified intermediary or as having an industry classification indicating that the payee is a financial institution.
- **Individual Accounts:** Participating FFIs now generally have until December 31, 2014, to complete diligence with respect to preexisting high-value individual accounts (subject to extension if the participating FFI signs its FFI agreement after January 1, 2014). For preexisting individual non-high-value accounts, the deadline is December 31, 2015, again subject to adjustment if the participating FFI signs its FFI agreement after January 1, 2014. A “high-value account” is generally defined in the proposed regulations as an account with a balance

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1. For background information regarding FATCA and the proposed regulations thereunder, please see our March 5, 2012, LawFlash “FATCA Proposed Regulations Unveiled by Treasury” at [http://www.morganlewis.com/pubs/Tax\\_LF\\_FATCAProposedRegsUnveiled\\_5mar12](http://www.morganlewis.com/pubs/Tax_LF_FATCAProposedRegsUnveiled_5mar12).

2. View the full Announcement at <http://www.irs.gov/pub/irs-drop/A-12-42.pdf>.

or value exceeding \$1 million at the end of the calendar year preceding the effective date of the participating FFI's FFI agreement or at the end of any subsequent calendar year.

The Announcement also provides that the final FATCA regulations will allow FFIs an additional six months to enter into an FFI agreement with the Treasury and IRS (and therefore become participating FFIs). Under prior guidance, FFIs would have been required to enter into an FFI agreement by June 30, 2013, in order to avoid imposition of FATCA withholding as of January 1, 2014. Specifically, the Announcement now provides that FFI agreements entered into prior to January 1, 2014, will be effective as of January 1, 2014, allowing FFIs to be treated as participating FFIs and therefore avoid withholding on payments of interest, dividends, and similar types of Fixed, Determinable, Annual or Periodical (FDAP) income as of January 1, 2014.

## **First Reporting Due Date Postponed by Six Months**

Under the final FATCA regulations, participating FFIs will be required to report to the IRS information concerning their U.S. accounts as well as accounts held by noncooperative account holders with respect to the 2013 and 2014 calendar years no later than March 31, 2015. Previously, participating FFIs were required to file their first report in respect of the 2013 calendar year by September 30, 2014. Since reports for a given year are required to be filed by March 31 of the following year, no additional time is given for filing the report for the 2014 calendar year. This is the same date on which first reporting is due under the model IGA.

## **Withholding on "Gross Proceeds" Postponed Until January 1, 2017**

Under FATCA, gross proceeds from the sale of instruments that give rise to U.S. source dividends and interest are potentially subject to a 30% withholding tax. The Announcement provides that the final regulations will revise the term "withholdable payment" so that gross proceeds from any sale or disposition occurring after December 31, 2016, will be subject to withholding. Under the proposed regulations, gross proceeds from sales or dispositions occurring after December 31, 2014, would have been subject to withholding. As a result of this change, reporting with respect to gross proceeds subject to withholding will not begin until 2018 with respect to the 2017 calendar year.

## **Scope of "Grandfathered Obligations" Expanded**

The Announcement provides that the final regulations will treat three additional types of instruments as "grandfathered obligations" (i.e., instruments not subject to FATCA withholding). First, given that the term "foreign passthru payment" currently is undefined in the proposed FATCA regulations, an obligation that produces or could produce a "foreign passthru payment" but not a withholdable payment will be a grandfathered obligation so long as it is outstanding on the date that is six months after the date on which final regulations that define the term "foreign passthru payment" are filed with the *Federal Register*. Second, instruments that produce withholdable payments solely because they are treated as giving rise to dividend equivalent payments, pursuant to section 871(m) of the Internal Revenue Code and the regulations thereunder, will be grandfathered obligations, provided they are outstanding on the date that is six months after the first date on which they first become subject to such treatment. Finally, a grandfathered obligation includes any obligation to make a payment with respect to, or to repay, collateral posted to secure obligations under a notional principal contract that is itself a grandfathered obligation.

## **Other Key Deadlines Not Affected**

No revisions were announced regarding the start of withholding on FDAP income or on "foreign passthru payments." As a result, FATCA withholding on FDAP income will commence with respect to payments made on or after January 1, 2014, and "foreign passthru payments" will not be subject to withholding any earlier than January 1, 2017. Moreover, since participating FFIs are still required to provide reports to the IRS with respect to the 2013 calendar year (albeit on an extended time frame), they are still required to begin the diligence process in 2013 in order to complete such reporting. The Announcement provides that, while the final regulations provide additional time for diligence on preexisting accounts, once an account has been documented, that account will be immediately subject to applicable withholding or reporting (as appropriate) even though the time period for

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completing identification and documentation of preexisting accounts as discussed above has not expired.

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