

Client Alert



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IRS Announces Timelines for Due Diligence and Other Requirements under FATCA

The Internal Revenue Service released an Announcement on October 24, 2012 pushing back and clarifying certain timelines for the compliance by withholding agents and foreign financial institutions (FFIs) with due diligence and related requirements under the Foreign Account Tax Compliance Act (FATCA).¹ The IRS intends to incorporate the rules from the Announcement into the final FATCA regulations scheduled to be released by the end of 2012. Given the potential uncertainty surrounding the release of the final regulations and ongoing negotiations to implement further intergovernmental FATCA agreements (IGAs), the announced modifications provide welcome transitional relief and clarification to FFIs in phasing in the due diligence and reporting obligations under FATCA.

What Is New?

The Announcement responds to written comments submitted in response to the release of the proposed FATCA regulations earlier this year and to oral comments made at the public hearing on those regulations.² Some financial institutions expressed particular concern with meeting the due diligence timelines set forth in the proposed regulations. Commenters also suggested aligning the due diligence timelines for US withholding agents, FFIs in countries with IGAs and FFIs in those countries without such agreements, in order to reduce the administrative burden on FFIs and particularly on multinational entities. Additional comments addressed certain foreign passthru payments and grandfathered obligations.

In general, the Announcement defers certain due diligence timelines (in relation to those set out in the proposed regulations) from six months to one year, while taking into account when an FFI enters into an FFI agreement. The due diligence obligations addressed include the implementation of new account opening procedures, due diligence on pre-existing obligations and accounts, and withholding and documentation for “prima facie FFIs”.

The Announcement outlines additional guidance regarding the first report due from participating FFIs (PFFIs, those FFIs that have entered into an FFI agreement) with respect to US accounts, gross proceeds withholding and the scope of grandfathered obligations. Lastly, the Announcement provides a

¹ See Announcement 2012-42, 2012-47 IRB 1, available at <http://www.irs.gov/pub/irs-drop/A-12-42.pdf>.

² For text of the proposed regulations, see REG-121647-10, 77 Fed. Reg. 9022, available at www.irs.gov/pub/newsroom/reg-121647-10.pdf.

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timeline summary that may be useful for FFIs in assessing their obligations to perform due diligence procedures to identify and document accounts. A modified version of this timeline is also included at the end of this client alert.

Due Diligence Timelines – New Account Opening Procedures and Preexisting Obligations

The Announcement clarifies that withholding agents, including PFFIs and deemed-compliant FFIs, will generally be required to implement new account opening procedures under the regulations by January 1, 2014 rather than by January 1, 2013. Consistent with this requirement, the effective date of an FFI agreement entered into before January 1, 2014, will be January 1, 2014. These modifications align the proposed regulations with the model IGA (Model I IGA) released in July,³ which requires new account opening procedures to be implemented by January 1, 2014.

The Announcement effects these changes by altering the definition of a “preexisting obligation.” Under the Announcement, this definition will include any account, instrument or contract maintained or executed by the withholding agent or FFI prior to the following dates, based upon the FATCA status of the FFI:

- January 1, 2014, for withholding agents other than a PFFI or a registered deemed-compliant FFI.
- The later of January 1, 2014, or the date an applicable FFI agreement becomes effective, for a PFFI.
- The later of January 1, 2014, or the date of registration as a deemed-compliant FFI, for a registered deemed-compliant FFI.

The final regulations will also include modified transition rules for completing due diligence on pre-existing obligations. The revised deadlines with respect to withholding and documentation depend upon the FATCA status of the withholding agent and the payee. It should be noted that, according to the timeline summary in the Announcement, once an account has been documented, for example as a US account or as an account of a non-PFFI, then appropriate withholding or reporting must begin at that time even though the time period for completing the identification and documentation of preexisting accounts may not have expired.

Withholding and Documentation for Prima Facie FFIs

Withholding agents other than PFFIs will be required to document payees that are classified as prima facie FFIs by June 30, 2014. (A “prima facie FFI” is generally a payee for which the withholding agent has available as a part of its electronically searchable information a designation as a “qualified intermediary” or “nonqualified intermediary” for purposes of the 30 percent withholding tax on US source income paid to foreign persons.) A withholding agent will not be

³ See reciprocal and nonreciprocal versions of the Model I IGA, available at <http://www.treasury.gov/press-center/press-releases/Pages/tg1653.aspx>.

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required to withhold on payments made to a prima facie FFI with respect to a preexisting obligation prior to July 1, 2014 (rather than January 1, 2014, as under the proposed regulations), unless the withholding agent has documentation establishing the payee's status as a non-PFFI. However, beginning on July 1, 2014, the withholding agent will be required to treat payees that are prima facie FFIs as non-PFFIs until the withholding agent obtains documentation sufficient to establish a different FATCA status for the payee FFI.

The deadline for PFFIs tracks the same date, but accounts for when the PFFI enters into an FFI agreement. A PFFI will be required, within six months after the effective date of its FFI agreement (also by June 30, 2014, for any FFI that enters into an FFI agreement by December 31, 2013), to perform due diligence to determine whether a prima facie FFI payee is a PFFI, deemed-compliant FFI, or non-PFFI. The presumption rules will apply to a prima facie FFI payee with respect to a preexisting obligation beginning six months after the effective date of the payor's FFI agreement.

Withholding and Documentation for Other Preexisting Entity Obligations

With respect to pre-existing obligations (tracking the modified definitions above), withholding agents other than PFFIs will be required to document payees that are entities other than prima facie FFIs by December 31, 2015 (rather than by December 31, 2014, as under the proposed regulations). Beginning on January 1, 2016, a withholding agent will be required to treat any undocumented payee that is treated as a foreign entity but that is not a prima facie FFI as a non-PFFI until the withholding agent obtains documentation sufficient to establish a different FATCA status for the payee.

A PFFI will have a similar timeline, again accounting for the date when it enters into an FFI agreement. A PFFI will have until the later of December 31, 2015, or two years after the effective date of its FFI agreement, before it is required to complete due diligence to determine whether an entity, other than a prima facie FFI, is itself a PFFI. A PFFI will not be required to apply the presumption rules to such accounts until the day after this same date for completing due diligence (that is, no earlier than January 1, 2016).

Withholding and Documentation of PFFIs with Preexisting Individual Accounts

Consistent with the Model I IGA, a PFFI must perform due diligence to identify high-value preexisting individual accounts by the later of December 31, 2014, or one year from the effective date of the FFI's FFI agreement. After this date, a PFFI must treat any high-value preexisting account as held by a recalcitrant account holder unless the PFFI has performed the required due diligence for that account.

Also consistent with the Model I IGA, a PFFI has an additional year to perform the required due diligence to identify preexisting individual accounts other than high-value accounts – until the later of December 31, 2015, or two years from the effective date of the FFI's FFI agreement. After this date, a PFFI must treat any preexisting individual account other than a high-value account as held by a

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recalcitrant account holder unless the PFFI has performed the required due diligence for that account.

Other Modifications for the Final Regulations

Due Date for First Report of a PFFI

The final regulations will provide that a PFFI will be required to file the information reports for calendar years 2013 and 2014 not later than March 31, 2015. This modification extends by six months the requirement with respect to calendar year 2013 in the proposed regulations, which provided a filing deadline of September 30, 2014, for that year. Under the Model I IGA, an FFI's reporting deadline will be set by domestic law in the foreign country, but the tax authorities of that country will need the information for calendar years 2013 and 2014 in time to transmit it by September 30, 2015, to the IRS.

Gross Proceeds Withholding

The start date for FATCA withholding on gross proceeds is pushed back by two years to January 1, 2017. A "withholdable payment" will include gross proceeds from any sale or other disposition occurring after December 31, 2016, of any property of a type that can produce interest or dividends that are US source FDAP income.⁴ This modification transitions the start date from after December 31, 2014, under the proposed regulations.

Scope of Grandfathered Obligations

The final regulations will clarify the scope of the grandfathered obligation rules to include several specific categories of obligations as grandfathered obligations. In the proposed regulations, a "grandfathered obligation" includes any obligation outstanding on January 1, 2013. An "obligation" means any legal agreement that produces or could produce a passthru payment, but does not include items treated as equity for US tax purposes, as well as savings or demand deposits, among other exceptions.

Three categories of obligations are to be specifically included as grandfathered obligations in the final regulations. The first category is any obligation that produces or could produce a foreign passthru payment and that cannot produce a withholdable payment, provided that the obligation is outstanding as of six months after the date of the final regulations defining the term "foreign passthru payment". While the preamble to the proposed regulations discusses foreign passthru payments, this term is specifically reserved for the final regulations and is not defined in the proposed regulations. This announced modification will at least provide some transitional relief following the definition of the term in the final regulations.

The second category of obligation to be grandfathered is any instrument that gives rise to a "dividend equivalent payment" (generally, payments on notional principal contracts based on US source dividends) that is a withholdable

⁴ For the general FATCA definition of "withholdable payment" including fixed or determinable annual or periodical (FDAP) income, see Internal Revenue Code § 1473(1)(A).

payment, provided that the instrument is outstanding six months after the date on which instruments of its type first become subject to such treatment. The third category is any obligation for repayment of collateral posted to secure obligations under a grandfathered notional principal contract.

What Happens Next?

Treasury has announced that the final regulations should be released by the end of 2012. Given the announced modifications and conformity of the timelines for FFI due diligence obligations, the expectation appears to be that most FFIs required to do so will enter into FFI agreements (or register as deemed compliant) sometime in 2013. While the announced modifications provide some additional transitional relief, FFIs will still need to begin collecting information for reporting with respect to the 2013 calendar year and continuing according to the phased-in deadlines in the final regulations or an applicable IGA.

Treasury continues to push ahead with efforts at negotiating bilateral IGAs with other countries. FFIs covered by the Model I IGA should not be required to enter into their own FFI agreements, since information would be provided directly to their domestic taxing authority and exchanged automatically with the IRS. The Model I IGA template has already been released, and an agreement has been signed with the United Kingdom, with further agreements currently being negotiated.

Under the Model II IGA, by contrast, FFIs would still be required to conclude their own FFI agreements with the IRS, although they should benefit from provisions for deemed-compliant FFIs and perhaps some relaxed due diligence provisions. While the Model II IGA should rely mainly on the final regulations, it remains to be seen how much it may modify the requirements of the regulations. The United States is far along in negotiations of a Model II IGA with Switzerland and Japan, and has announced that release of the Model II IGA template should occur soon. In countries that do not enter into an IGA, FFIs will fall under the final regulations.

Key Revised FATCA Compliance Deadlines for FFIs and Other Withholding Agents

The following summary timeline chart is modeled on the Announcement. This chart details the timeline for compliance by the various types of withholding agents according to account type. As discussed above and as noted by the IRS in the Announcement, these dates represent deadlines for compliance. Once a particular account has been documented, however, for example as a US account or as an account of a non-PFFI, the withholding agent must begin withholding (starting January 1, 2014) or reporting (by the first report date of March 31, 2015), as appropriate, with respect to that account even though the deadline (see summary below) for completing the due diligence process may not yet have expired.

Summary of Due Diligence and FFI Agreement Deadlines

	Implementation of new account opening procedures	Preexisting Accounts of Prima Facie FFIs	Preexisting Accounts of Entities other than Prima Facie FFIs	Preexisting High Value Accounts of Individuals	Preexisting Accounts of Individuals other than High Value Accounts	Entering into an FFI Agreement
PFFIs	Jan. 1, 2014 (or later eff. date of FFI Agmt.)	Later of June 30, 2014, or 6 months after eff. date of FFI Agmt.	Later of Dec. 31, 2015, or two years after eff. date of FFI Agmt.	Later of Dec. 31, 2014, or one year after eff. date of FFI Agmt.	Later of Dec. 31, 2015, or two years after eff. date of FFI Agmt.	Dec. 31, 2013
Registered Deemed-Compliant FFIs	Jan. 1, 2014 (or later date of registration)	N/A	N/A	N/A	N/A	N/A
US Withholding Agents	Jan. 1, 2014	June 30, 2014	Dec. 31, 2015	N/A	N/A	N/A

Earliest Effective Date of an FFI Agreement

- January 1, 2014 (even if signed in 2013)

Implementation of New Account Reporting Procedures:

- January 1, 2014 – US withholding agents, PFFIs (or effective date of FFI agreement) and registered deemed-compliant FFIs (or date of registration as deemed-compliant)

Preexisting Accounts – Documentation

- June 30, 2014 with respect to clients identified as prima facie FFIs – US withholding agents, PFFIs (or six months after effective date of FFI agreement) and registered deemed-compliant FFIs
- December 31, 2014 with respect to high value individual accounts – PFFIs
- December 31, 2015 with respect to other entity clients not identified as prima facie FFIs – US withholding agents, PFFIs (or two years from effective date of FFI agreement) and registered deemed-compliant FFIs

- December 31, 2015 with respect to non-high value individual accounts – PFFIs

Reporting of PFFIs

- March 31, 2015 – first report for 2013 and 2014 calendar years

Withholding Requirements

- January 1, 2014 – income withholding begins on new accounts
- July 1, 2014 with respect to clients identified as prima facie FFIs – US withholding agents, PFFIs (or six months after effective date of FFI agreement) and registered deemed-compliant FFIs
- January 1, 2015 with respect to high value individual accounts – PFFIs
- January 1, 2016 with respect to other entity clients not identified as prima facie FFIs – US withholding agents, PFFIs (or two years from effective date of FFI agreement) and registered deemed-compliant FFIs
- January 1, 2016 with respect to non-high value individual accounts – PFFIs
- January 1, 2017 – gross proceeds withholding begins
- January 1, 2017 – foreign passthru payments withholding begins

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