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TaxNewsFlash
UNITED STATES

No. 2013-39
January 21, 2013

FATCA - KPMG's initial analysis of final regulations

January 21: The U.S. Treasury Department and IRS on January 17, 2013, released final regulations for the Foreign Account Tax Compliance Act (FATCA).

Since the enactment of FATCA in March 2010, Treasury and the IRS have issued several rounds of preliminary guidance, including proposed regulations. The recently released final regulations have been much anticipated by taxpayers that expect to be affected by the new FATCA withholding and reporting regime, particularly in light of the looming January 1, 2014 effective date (i.e., December 31, 2013, for participating foreign financial institutions).

Read text of the final regulations: T.D. 9610 [PDF 1.1 MB]

Background

In an effort to curb perceived tax abuses by U.S. persons with offshore bank accounts and/or investments, Congress passed broad, sweeping legislation intended to combat offshore tax evasion by such persons. Specifically, FATCA (signed into law on March 18, 2010) incorporates a new chapter 4 reporting regime that is designed to achieve this stated intent by imposing a severe withholding tax on certain foreign entities that refuse to disclose the identities of these U.S. persons.

The statute—while providing very general information with respect to the new withholding and reporting rules—deferred much of the administration and implementation of the new regime to Treasury and the IRS.

While uncertainty remains (given the adoption of an intergovernmental alternative approach to FATCA, which many countries are expected to follow, and the lack of final withholding certificates and reporting forms), the final regulations take affected entities one step closer toward the ability to implement their FATCA compliance programs.

The Preamble to the final regulations states that Treasury and the IRS carefully considered stakeholders' comments in an effort "to develop an implementation approach that achieves an appropriate balance between fulfilling the important policy objectives of chapter 4 and minimizing the burdens on stakeholders."

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Significantly, the Preamble further states that Treasury and the IRS have carefully considered the hundreds of comments received and established three avenues for addressing the principal concerns—(1) burdens, (2) legal impediments, and (3) technical implementation.

The methodology for addressing the first avenue was to adopt a risk-based approach to effectively address policy concerns, eliminate unnecessary burdens and, when possible, build on existing practices and obligations. To address the local impediments, Treasury and the IRS collaborated with other governments to develop the alternative intergovernmental approach via intergovernmental agreements (IGAs) that eliminate those conflicts of law while achieving the intent of the statute. Treasury and the IRS addressed the third avenue by stating that they will simplify the process for foreign financial institutions (FFIs) registering and executing the FFI Agreement.

Executive summary

As mentioned above, in finalizing the FATCA rules, Treasury and the IRS made efforts to minimize burdens, when possible, and address the issue of local law conflicts. Several of the key provisions are summarized below:

- Harmonization with intergovernmental agreements
- Relaxation of certain documentation and due diligence requirements
- An expanded scope of "grandfathered obligations"
- Liberalization of requirements for certain retirement funds and savings accounts
- Limited FFIs – continued transition rule
- Bearer shares
- Brokers (delivery vs. payments)
- Registration process

Harmonization with intergovernmental agreements

In general, the most significant changes contained in the final regulations are attributable to Treasury and the IRS's attempt to harmonize the final regulations with the requirements set forth in the IGAs. Such harmonization is critical to the compliance success for global institutions that operate both within and without IGA countries. The most notable modification is found in the new definition of an FFI.

Under the proposed regulations, a broad definition of a financial institution included any entity that is primarily engaged in the business of investing,

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reinvesting, or trading in securities, commodities, partnership interests, etc. For this purpose, an entity was considered primarily engaged in such activities if its gross income attributable to such activities equaled or exceeded 50% during the relevant testing period. Given this definition, foreign funds, collective investment vehicles, as well family trusts and passive investment corporations (PICs) would have been considered FFIs—and not passive non-financial foreign entities (NFFEs). This distinction is significant in terms of compliance requirements.

A passive NFFE must provide:

- A certification that it has no substantial U.S. owners (more than 10% direct or indirect ownership), or
- The name, address, and taxpayer identification number (TIN) of each such owner[1]

An FFI, on the other hand, must enter into a formal agreement with the IRS and agree to, among other things, identify and report its U.S. accounts or meet one of the deemed compliant or other excepted categories.

It would have been possible for a family trust or PIC to satisfy the requirements of a deemed compliant owner-documented FFI (ODFFI) if its withholding agent had agreed to treat it as an ODFFI and it had disclosed information (reporting statement and documentation) relating to all of its underlying owners.

Pursuant to the IGAs, the definition of this category of FFI changed significantly. Specifically, in lieu of the proposed regulations' definition (outlined above), a "Partner Country FI" includes an "Investment Entity," which means "any entity that conducts as a business (or is managed by an entity that conducts as a business)" trading, portfolio management, or investing, administering, or managing funds "for or on behalf of a customer."

Given this new definition, fund managers—as well as the funds they manage—are considered FIs. However, PICs or family trusts, ***if*** organized in an IGA country, are generally not.[2] This is because they do not engage in any of the activities listed above for customers nor are they generally managed by an entity that does.

[1] Pursuant to the IGA, the Partner FI would obtain self-certifications from the Passive NFFE and its Controlling Person(s) (generally 25% owners).

[2] The place of organization is significant because the IGA defines an NFFE as a non-U.S. entity that is not an FFI as defined in the U.S. Treasury regulations and also includes any non-U.S. entity that is organized under an IGA country and that is not a financial institution. Presumably, this latter reference to financial institution is the IGA definition. Consequently, PICs and family trusts that are organized in IGA countries are likely to be treated as passive NFFEs whether they are managed or not.

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It is significant to note that the IGA definition of "Investment Entity" also contains a catch-all sentence at the end that provides that the definition "shall be interpreted in a manner consistent with similar language set forth in the definition of 'financial institution' in the Financial Action Task Force (FATF) Recommendations."

While the definition of "financial institution" pursuant to the FATF Recommendations is controversial, a self-managed fund generally would fall within the definition and, thus, should be treated as an FI under the IGAs (notwithstanding the fact that it does not meet the literal definition). Conversely, it is also likely that a managed family trust or managed PIC, organized in an IGA country, would not fall within that definition and, thus, should not be considered FIs under the IGAs.

The final regulations adopt the IGA's "investment entity" concept, though not in its entirety. This is because the definition of an investment entity under the final regulations does not include the catch-all sentence regarding the definition of a "financial institution" under the FATF Recommendations. The regulations do, however, explicitly include most collective investment vehicles—managed or not—within the definition of Investment Entity. This leaves an anomaly between the IGAs and the regulations with respect to the treatment of managed family trusts and managed PICs that are organized in an IGA country (FFIs under the regulations and Passive NFFEs under the IGAs).

This inconsistency would not necessarily be problematic but for the fact that the documentation requirements, as noted above, are considerably different. Given this, an institution that operates both within and without IGA countries, and that is FATCA-compliant with respect to all of its financial accounts, could become non-compliant simply by transferring a line of business or trading desk from a branch operation in an IGA country to one that is not.

In addition to the above, the final regulations contain another, more baffling, harmonization modification as it relates to Passive NFFEs. Under the proposed regulations, a withholding agent was required to treat an undocumented NFFE as a nonparticipating FFI (NPFFI). The final regulations modify this when the withholding agent is a participating FFI (PFFI) that maintains an account for a Passive NFFE and has documentation for the Passive NFFE, but does not have the requisite certification that the entity has no substantial U.S. owners (or the name, address, and TIN of such owner(s)). In this circumstance, the PFFI must treat the account holder as a recalcitrant account holder and not a NPFFI.

Conversely, when the withholding agent is a U.S. withholding agent or a PFFI that does not maintain an account for the Passive NFFE (e.g., a PFFI that has entered

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into a swap contract with the Passive NFFE), the final rules retain the requirement to treat the entity as an NPFFI. This ensures that withholding will be imposed when the PFFI makes a payment when there is no account (the rules do not require an "account" for withholding on payments to an NPFFI).

This modification was presumably made to align the final regulations with the IGAs, where possible. [The IGAs cross reference Code section 1471(d)(6) for the definition of a recalcitrant account holder, which includes an account holder when the withholding agent is unable to obtain the information necessary to determine whether the account is a U.S. account.]

The change is baffling, though, because the treatment of a recalcitrant account holder under the IGA is very different from the treatment under the regulations. In addition, it seems to result in unnecessary complexity without a corresponding benefit to the IRS. In fact, had the government retained the rule in the proposed regulations, it would have received withholding and, in certain circumstances, payee-specific reporting—regardless of whether the PFFI maintained an account or not. As drafted, the government will never know the name of the Passive NFFE when the PFFI does maintain an account because reporting for recalcitrant account holders is never payee-specific.

On a different note relating to harmonization, the final regulations do not adopt the IGAs' higher thresholds for determining whether a Passive NFFE is U.S. owned and, thus, a U.S. account (e.g., 25%). Instead, the final regulations retain the more than 10% threshold as set forth in the statute and proposed regulations. This variation will be challenging for global institutions that had hoped to implement uniform practices and procedures across their operations.

A final noteworthy point relating to this new definition of FFI is found in an example. The example sets forth facts whereby a fund is managed by a fund manager. The fund manager, in turn, hires an investment advisor to provide investment advice. The investment advisor generates more than 50% of its income from providing investment advice (the threshold necessary to "primarily" conduct as a business one of the listed investment activities). Because of this, the example concludes that the investment advisor is an Investment Entity.

There appears to be a problem with the example and conclusion, however, because an entity that solely provides investment advice would not ordinarily be engaging in one of the listed investment activities (i.e., it is not trading, performing portfolio management, or investing, administering, or managing funds or financial assets of others). Regardless, it is unclear why the United States would be interested in the owners of an offshore investment advisor.

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Relaxation of certain documentation and due diligence requirements

Following Treasury and the IRS's stated risk-based approach and attempt to leverage existing information that a withholding agent or FFI may have for other business and regulatory purposes, the final regulations bring some welcomed relief relating to account documentation, validity periods of documentation, and associated due diligence.

1. Documentation

The final regulations contain much needed account-documentation relief in various instances. For certain U.S. account holders, the regulations permit a withholding agent to rely on documentary evidence in lieu of a Form W-9 for U.S. persons that are not specified U.S. persons. This is a substantial departure from the proposed regulations that had effectively eliminated the so-called "eyeball test" and required a withholding agent to presume certain exempt recipients (i.e., corporations and financial institutions) to be NPFFIs unless a Form W-9 was on file. Because withholding agents are not required to obtain Forms W-9 from these entities under the current withholding and reporting regime, this would have required very expensive remediation efforts—notwithstanding the withholding agents' actual knowledge that the account holders are not specified U.S. persons.

For certified deemed compliant FFIs (other than the new category of sponsored FFI), retirement funds, nonprofit organizations, and excepted NFFEs, the final regulations require that a withholding agent obtain a withholding certificate with the proper certifications. Unlike the proposed regulations, the withholding agent is no longer required to also obtain financial statements, letters from counsel, etc. to corroborate the claims made. In addition, the final regulations include additional relief for offshore accounts (generally, a requirement to obtain only written statements when the account holder does not receive payments of U.S. source FDAP and written statements and documentary evidence when it does).

The final regulations also provide some welcomed documentation relief for owner-documented FFIs (ODFFIs).

- First, the reporting statement and documentation requirement has been scaled back to require information relating only to direct or indirect owners that are individuals and specified U.S. persons (looking through all entity owners for such persons).
- Second, the reporting statement is no longer required to contain allocation information and is no longer required to be updated annually.

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- Third, the final regulations provide additional relief for offshore accounts when the ODFFI's account balance is $1 million or less. For those accounts, the withholding agent may treat the account as held by an ODFFI if (1) it has collected documentation sufficient to identify any owner that is an individual or specified U.S. person; (2) the documentation obtained satisfies its AML due diligence requirements; (3) the withholding agent has sufficient information to report all specified U.S. persons; and (4) the withholding agent does not know or have reason to know the entity has any contingent beneficiaries, unidentified owners, NPFFI owners, or that any NPFFIs or specified U.S. persons own a debt interest in excess of $50,000 in the payee (other than a specified U.S. person that the withholding agent has sufficient information to report).

Another important provision relating to documentation addresses inconsequential errors. Specifically, the regulations provide that an inconsequential error will not invalidate a tax form if the withholding agent has other account file information that conclusively cures the error. Troubling, however, is an example that describes a country abbreviation on a form provided by an individual. The example concludes that the withholding agent can "cure" the abbreviated address if it has government-issued identification for the person that reasonably matches the abbreviated country on the form.

The example is troubling because, both informally at withholding conferences and on audit, the IRS has generally taken the position that an abbreviated country on a Form W-8 does not invalidate the form as long as the withholding agent can easily discern the country from the abbreviation (e.g., U.K.). In addition, because the form is only being used to establish non-U.S. status, if additional documentary evidence is to be required, government-issued identification from any non-U.S. country should suffice.

Finally, the Preamble indicates that a withholding agent will be permitted to obtain documentation electronically (i.e., via facsimile or scanned documents transmitted via email). However, the final regulations cross-reference the section 1441 regulations that permit electronically submitted forms.

Currently, those rules would not permit a withholding agent to accept a form via facsimile or one that was otherwise scanned into an electronic system for submission (because they do not contain the requisite electronic signature). It is anticipated that the section 1441 regulations that are cross-referenced will be updated to permit such transmissions in the near future. This is something that withholding agents have requested since the implementation of the current withholding regime in 2001 and should allow them to simplify documentation processes a great deal.

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2. *Documentation validity*

As mentioned above, another area of significant relief is found in the final regulations' provisions relating to documentation validity.

Under the proposed regulations, absent a change in circumstances, the validity period for most documentation was the year signed (year presented for documentary evidence) plus three full calendar years. For documentary evidence with an expiration date, the validity period ended on that expiration date—even if the date was before the end of the three-year period. This rule was very onerous because, under anti-money laundering (AML) and know-your-customer (KYC) regulations, a withholding agent is rarely required to refresh documentation, even if it has expired.

The final regulations provide, as the general rule, the "three plus" rule outlined above. Of particular interest, however, are the numerous new exceptions. Specifically, absent a change in circumstances, the following documentation (among others) will have an indefinite validity period:

- Withholding certificate or statement from a PFFI or registered deemed compliant FFI (RDCFFI) that has furnished a Global Intermediary Identification Number (GIIN) that has been verified pursuant to those requirements

- A Form W-8BEN provided by an individual claiming non-U.S. status if it is supported by documentary evidence and there are no current U.S. addresses or U.S. telephone number(s) that are the only telephone number(s) on file

- A withholding certification from any of the following entities claiming non-U.S. status (if such entity is the payee and the withholding certificate is furnished with documentary evidence establishing the entity's non-U.S. status):

    - Exempted retirement fund or an entity wholly owned by such fund
    - Excepted non-financial group entity
    - 501(c) entity
    - Non-profit organization
    - Nonreporting IGA FFI
    - Territory financial institution that agrees to be treated as a U.S. person
    - NFFE whose stock is regularly traded (and an affiliate thereof)

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  - An active NFFE (that is monitored through AML due diligence)
  - Sponsored FFI

- A withholding certification from an intermediary, flow-through entity, or U.S. branch (not including the underlying owner documentation or withholding statement)

- A withholding certificate, written statement, or documentary evidence furnished by a foreign government, government of a U.S. territory, foreign central bank (including the Bank for International Settlements), international organization, or an entity that is wholly owned by any such entities, and

- Documentary evidence that is generally not renewed (e.g., articles of incorporation)

In addition, the list is expanded for offshore obligations:

- A Form W-8BEN ***or*** documentary evidence provided by an individual claiming non-U.S. status if the withholding agent does not have current U.S. addresses, U.S. telephone number(s) that are the only telephone number(s), or standing instructions to make a payment into the U.S. on file

- A withholding certificate, written statement, or documentary evidence provided any of the following entities (if such entity is the payee):

  - Exempted retirement fund or an entity wholly owned by such fund
  - Excepted non-financial group entity
  - 501(c) entity
  - Non-profit organization
  - Nonreporting IGA FFI
  - Territory financial institution that agrees to be treated as a U.S. person
  - NFFE whose stock is regularly traded (and an affiliate thereof)
  - An active NFFE (that is monitored through AML due diligence)
  - Sponsored FFI

- A withholding certificate of an ODFFI

- A reporting statement of an ODFFI with account balance of $1 million or less (if no contingent beneficiaries or designated class of unidentified beneficiaries)

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- A withholding certificate of a passive NFFE or excepted territory NFFE if the account balance does not exceed $1 million (and the withholding agent does not know or have reason to know the entity has contingent beneficiaries or designated classes of unidentified beneficiaries)

3. *Due diligence*

The due diligence rules—relating to when a withholding agent has "reason to know" that documentation is incorrect or invalid—are modeled very much after the existing chapter 3 rules. Specifically, the general rule provides that a withholding agent has reason to know that documentation is invalid when a "reasonably prudent person in the position of a withholding agent" would question the claims made.

As in chapter 3, the rules contain specific fact patterns when a withholding agent would have such "reason to know" and the requisite curative documentation that it must obtain before it can accept the payee's original claim. These so-called "red flags" are very similar to those set forth in the chapter 3 rules (e.g., U.S. address or, for offshore obligations, standing instructions to pay inside the United States).

In addition, the chapter 4 rules add two more flags that withholding agents should be looking for when a payee claims foreign status—U.S. birthplace and U.S. telephone numbers.

In the proposed regulations, there had been one very important distinction between the two sets of rules---a clear safe harbor language in the chapter 3 rules. Specifically, for withholding agents that are financial institutions, the chapter 3 due diligence rules limit the circumstances of "reason to know" to those specifically stated in the regulations. The final regulations fix this inconsistency and make clear that a withholding agent has "reasons to know" that documentation is invalid or incorrect ***only*** if there is one of more of the listed U.S. indicia associated with the account.

4. *Expanded scope of grandfathered obligations*

Pursuant to the statute, a withholding agent would not be required to impose FATCA's penal withholding on any payments, including the gross proceeds from any disposition, related to an obligation that was outstanding on March 18, 2012.

The proposed regulations extended this relief by excluding, from the definition of withholdable or passthru payment, any payment made under an obligation outstanding on January 1, 2013.

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The final regulations extend this date further to include any obligation outstanding on January 1, 2014. The regulations also incorporate additional relief set forth in Announcement 2012-42—namely, an extension of this relief for:

- Obligations the payments of which will be captured under section 871(m) that are executed on or before the date that is six months after the date such obligations will be subject to those rules, and
- Any obligation the payment of which will be captured under the foreign passthru payment rules if the obligation is executed on or before the date that is six months after the date the final regulations defining that term are filed with the *Federal Register*

The final regulations make clear that the withholding relief also applies to any agreement requiring a secured party to make a payment with respect to, or to repay, collateral posted to secure a grandfathered obligation.

Other notable changes to the grandfathered rules include coverage for life insurance contracts that are payable upon the death of the insured. The proposed regulations did not include such contracts within those having the requisite definitive term.

In addition, to alleviate concerns voiced by withholding agents, the final rules provide that a withholding agent who is not the issuer of an obligation may, absent actual knowledge or reason to know otherwise, rely on a written statement by the issuer regarding whether the obligation qualifies for the grandfathered treatment. In addition, the withholding agent is only required to treat a modification as disqualifying the obligation from meeting the requirements for withholding relief if it knows or has reason to know such modification was material. For this purpose, the withholding agent will be treated as having reason to know if it receives a disclosure from the issuer.

Liberalization of requirements for certain retirement funds and savings accounts

With respect to retirement funds, the proposed rules provided that a retirement fund would meet the definition of an exempt beneficial owner if such fund was:

- Eligible for benefits pursuant to an income tax treaty between the United States and the fund's country of residence
- Exempt from income tax in the country of residence, and
- Operated principally to administer or provide pension or retirement benefits

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Unfortunately, many otherwise qualifying retirement funds failed to satisfy the requirements of the exception as originally drafted because, in many jurisdictions, such retirement funds are not the beneficial owner.

The final regulations clarify that, for purposes of this category of exempt beneficial owner only, the fund will still qualify as exempt even if it is not the beneficial owner. Given this, entities like certain Registered Retirement Savings Plans (RRSPs) in Canada should now meet the requirements of this exemption.

This category of exempt entity was also liberalized allowing, for example, alternative sources of contributions apart from employers and employees, funds that meet the requirements of section 401(a), and, in certain instances, plans that also provide disability or death benefits.

In addition to the above, the final regulations also loosen the requirements for certain retirement and savings accounts that are excluded from the definition of financial account. For retirement savings accounts, the requirements that all contributions to the account be from the government, employee or employer and limited to earned income have been eliminated. The limit on contributions has also been modified from a $50,000 annual limit only to a $50,000 annual limit or a maximum lifetime limit of $1 million. The final regulations do impose a new provision requiring reporting of the accounts to the relevant tax authorities.

For non-retirement savings accounts, the final regulations eliminate the requirement that contributions to such an account are limited by reference to earned income and, instead, require the account to be "tax-favored." For this purpose, an account is tax favored if:

- Contributions to the account that would otherwise be subject to tax are deductible or excluded from the gross income of the account holder or taxed at a reduced rate, or
- Taxation of investment income from the account is deferred or taxed at a reduced rate

Limited FFI – *Continued* transition rule

The limited FFI concept was adopted to help certain FFIs within expanded affiliated groups. Treasury and the IRS have consistently stated that all FFIs within an expanded affiliated group must either be a PFFI, DCFFI, or otherwise exempted from the rules. Understanding that certain FFIs operate in jurisdictions that prohibit disclosures of account holder information, closing of recalcitrant accounts, etc., Treasury and the IRS devised a transition rule for "limited FFIs."

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Specifically, the limited FFI rule would apply when an FFI within an expanded affiliate group is legally prohibited from either:

- For U.S. accounts – Reporting, closing, or transferring to a U.S. financial institution, PFFI, or reporting Model 1 FFI, or
- For recalcitrant account holders and accounts held by NPFFIs – Blocking, closing, or transferring to a U.S. financial institution, PFFI, or reporting Model 1 FFI

Pursuant to this concept, if an FFI in such a jurisdiction qualifies as a limited FFI, the IRS will permit the other FFIs within its expanded affiliated group to become PFFI and/or DCFFIs.

The limited FFI within the group must (1) register with the IRS, (2) agree to the account identification requirements as set forth in the FFI Agreement, and (3) retain such documentation for six years from the effective date of its registration as a limited FFI. It must also agree to report identified U.S. accounts to the extent permitted by law. Further, it must agree to not open any new U.S. or NPFFI accounts. Significantly, the rules provide that the limited FFI must be treated as an NPFFI for purposes of the penal withholding on reportable payments.

Under the proposed regulations, the limited FFI relief was transitional and ended on December 31, 2015. In the IGAs, however, the limited FFI in the group can continue to act in that capacity, indefinitely, without harming the compliant FATCA status of other group members, as long as certain conditions are met. It was anticipated that this same relief would be included in the final regulations. Unfortunately, Treasury and the IRS did not harmonize the two regimes with respect to the limited FFI. The final regulations continue to treat the limited FFI relief as transitional and retain the December 31, 2015 end date.

As discussed above, the limited FFI concept is incorporated into the rules to permit FFIs in an expanded affiliate group to become PFFIs or DCFFIs, notwithstanding the fact that one or more of the group members operates in non-IGA jurisdictions that prohibit it from complying with certain terms of the FFI Agreement.

The problem, however, is the fact that the relief is transitional. Even with the relaxation of certain FFI requirements, compliance with the FATCA regime will be both onerous and expensive. Under this transition relief, the FFIs in the group that have no legal prohibitions relating to full compliance will expend sizable resources, in terms of both time and money, developing systems and processes to satisfy the requirements of the FFI Agreement and/or an IGA. However, as

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drafted, the FFIs in the group that are not operating in IGA countries will lose their PFFI or DCFFI status after December 31, 2015, if there is a limited FFI in the group that cannot comply.

Adding to this problem is a new anti-abuse rule that provides that when an expanded affiliated group changes the ownership structure in an attempt to avoid withholding or reporting, the IRS will disregard such changes. As a result, the possible options are narrow:

- A law change in the limited FFI's country of operation that would permit the limited FFI to achieve full compliance
- The country in which the limited FFI operates enters into an IGA with Treasury, or
- The limited FFI ceases operations in that country by December 31, 2015

For some, it is likely that none of the possibilities is attainable from either a plausibility or timing perspective. Even if it was accepted that the country in which the limited FFI operates would be willing to change its laws to permit the limited FFI to achieve full FATCA compliance, it is unrealistic that such a law change could be enacted and implemented within this short transitional time period.

Further, as it is currently understood, to enter into an IGA, a country must have an income tax treaty, a tax information exchange agreement, or a local law that would permit the exchange of information with the United States. Any one of these requirements would likely take time to conclude. Given this, the remaining option is to cease operations. This does not make sense, especially in light of the accommodation made under the IGAs. Regardless, the final regulations continue to leave many FFIs in a difficult planning position.

Bearer shares

Prior guidance did not address the issue of bearer shares. This was of particular concern for many funds because many had issued bearer shares in the past and, thus, would not be in a position to identify accounts within the prescribed time limits.

The Model 2 IGA first mentioned the issue of bearer shares by stating that an investment fund that otherwise qualified would be treated as deemed compliant, notwithstanding the fact that it had bearer shares, as long as it:

- Has not issued, and does not issue, any physical shares in bearer form after December 31, 2011

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- Performs the due diligence procedures (and reports, when necessary) with respect to any such share when presented, and
- Has implemented policies and procedures to ensure that such shares are redeemed as soon as possible and, in any event, prior to January 1, 2017

Because of the nature of the shares (i.e., bearer), it is unclear how a fund could ensure that all such shares would be redeemed by January 1, 2017.

The final regulations provide that the account identification procedures for a pre-existing obligation in bearer form will be performed at the time the share is presented for payment. Notwithstanding the fact that the obligation is pre-existing, however, the PFFI must perform the new account identification procedures at that time. This new provision is vital for any PFFI that has outstanding bearer shares. Without it, the PFFI could never attain FATCA compliance as related to account identification.

In addition, under the final guidance, an otherwise qualifying fund that issued bearer shares in the past can nevertheless qualify as a registered deemed compliant qualified collective investment vehicle or restricted fund if it:

- Ceased issuing interests in bearer form after December 31, 2012
- Retires all such interests upon surrender
- Implements policies and procedures to redeem or immobilize all such interests prior to January 1, 2017, and
- Identifies the account prior to payment (under the new account procedures) and agrees to withhold and report as if it were a PFFI.

As indicated above, the 2017 cut-off date to "redeem or immobilize" may continue to make this exception unavailable to anyone with prior issued bearer shares.

Brokers (delivery vs. payments)

For brokers, it is interesting to note that the final regulations remove (and reserve) the withholding provision relating to payments of gross proceeds.

Specifically, the rule in the proposed regulations would have required each broker—including those that pay proceeds in a "delivery versus payment" or "cash on delivery" transaction—to withhold on the proceeds by reference to the FATCA status of the payee. This was an unusually onerous requirement based on the nature of these transactions (very high volume with no current processes or procedures in place to document the next broker in the chain or to withhold or

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report on the payment). Because this provision is reserved and not eliminated entirely, it may be premature for potentially impacted brokers to find much comfort.

Registration process

Finally, addressing Treasury and the IRS's third stated avenue—technical complications—the Preamble to the final regulations provides additional insight into the registration process for FFIs.

Specifically, the Preamble provides that the FATCA registration portal will be the primary means for financial institutions to interact with the IRS (e.g., complete and maintain chapter 4 registrations, agreements, and responsible officer certifications). The portal will be open for registration and agreement execution, when necessary, no later than July 15, 2013 (more than six months later than prior announcements).

The Preamble makes clear that reporting Model 1 FFIs will be required to register on the portal and will be issued a GIIN. The assignments of GIINs will take place no later than October 15, 2013.

According to the guidance, the IRS will publish the first list of PFFIs and RDCFFIs (including reporting Model 1 FFIs) on December 2, 2013. It is anticipated that the list will be updated on a monthly basis.

To be certain it is listed on the December 2, 2013 list, a PFFI or RDCFFI must register on the IRS portal by October 25, 2013. This new timeline will leave prospective PFFIs with very little time to analyze the specific requirements of the FFI Agreement, once released, and decide whether they will, in fact, enter into the Agreement by that October date.

For more information about the FATCA proposed regulations, contact a tax professional with KPMG LLP:

General information: Laurie Hatten-Boyd

Banking: Mark Price, Mark Naretti, Carl Cooper, Mindy Schmidt

Funds: Emma Preston, David Richardson, Deanna Flores

Insurance companies: Craig Pichette, Fred Campbell-Mohn, Jean Baxley

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