
IRS releases draft 'FFI agreement' under FATCA and related guidance: Long awaited piece of the puzzle contains surprising twists

November 1, 2013

In brief

The Internal Revenue Service (IRS) on October 29, 2013 released [Notice 2013-69](#) (the Notice) addressing foreign financial institution (FFI) agreements and related issues under the Foreign Account Tax Compliance Act (FATCA) and accompanying regulations. The Notice provides guidance to FFIs and branches of FFIs, including those treated as reporting financial institutions under an applicable Model 2 intergovernmental agreement (IGA). The Notice has been anticipated and provides guidance for stakeholders, but it also contains some surprising twists.

The Notice reiterates that certain entities or branches will enter into an FFI agreement with the IRS, while other types of entities must simply comply with its terms. The Notice also provides clarifications relating to certain Model 2 FFIs, branches, and the impact of non-compliant related entities. In addition, it introduces new concepts which the IRS will address in forthcoming regulations (e.g., the introduction of direct reporting non-financial foreign entities (NFFE) and new coordinating principles between FATCA withholding and Section 3406 backup withholding).

Importantly, the Notice includes a draft version of the FFI agreement and describes an FFI's general responsibilities. These responsibilities are substantially similar to the provisions set forth in the FATCA regulations but some new ones have been added. The Notice also provides miscellaneous guidance such as the application of a 90-day rule to the expiration of documentation, withholding requirements on preexisting accounts through certain due diligence time periods, and adjustments for underwithholding and overwithholding.

The Notice also indicates that the FFI agreement will be finalized by December 31, 2013, but does not request comments. As with all FATCA guidance, stakeholders should review how the new information affects their overall strategy and project plans for complying with FATCA.

In detail

Entities or branches that can enter into an FFI agreement

The Notice specifies which entities can enter into an FFI

agreement with the IRS. Consistent with the FATCA regulations, FFIs that have one or more branches (including its home office or a US branch) that can comply with the terms of an

FFI agreement are eligible to enter into such an agreement. Reporting Model 1 or 2 FFIs may also enter into an FFI agreement for their branches located outside of a Model 1 or 2

IGA jurisdiction. If a branch of an FFI is unable to satisfy all of the terms of the FFI agreement due to prohibitions under the laws of the jurisdiction in which the branch is located, it will not be eligible to enter into an FFI agreement.

Model 2 FFIs

Similar to Model 1 FFIs, a Model 2 FFI is not required to enter into an FFI agreement with the IRS. However, Model 2 FFIs are required to comply with the terms of the FFI agreement (as modified by the applicable Model 2 IGA) and report specific information about US accounts directly to the IRS in order to be treated as FATCA compliant. Under the terms of the FFI agreement, however, a reporting Model 2 FFI may be required to withhold on withholdable payments made to non-participating FFIs (NPFFIs) and may also have to withhold on withholdable payments to recalcitrant account holders, if certain conditions are not met.

Since Model 2 FFIs are required to comply with the terms of the FFI agreement, the provisions of the Notice also apply to Model 2 FFIs, except in certain cases where they are treated differently under their specific IGA. For example, the Model 2 IGA permits suspension of FATCA withholding on accounts owned by non-consenting or recalcitrant account holders.

Treatment of branches

The Notice provides that a Model 1 or 2 FFI that has a branch outside of a Model 1 or 2 jurisdiction may enter into an FFI agreement with respect to such branch in order for the branch to be treated as a participating FFI (PFFI). In such case, the terms of an FFI agreement apply to the operations of the branch treated as a PFFI.

Non-compliant related entities

The draft FFI agreement provides that a Model 2 FFI will not lose its FATCA-compliant status due to a related entity being non-compliant because either: 1) it is prohibited by local law from complying; or 2) it is non-compliant solely because of the expiration of the transitional rules for limited branches or limited FFIs in its expanded affiliated group (EAG). Limited branches and limited FFIs are unable to comply with the FATCA rules because they are prohibited by local law from withholding, reporting, and/or closing customer accounts as required under FATCA.

If a limited FFI or limited branch is no longer prohibited from complying, the PFFI must notify the IRS on the FATCA registration website by the beginning of the third calendar quarter following the date that the FFI or branch ceases to be a limited FFI or limited branch. Moreover, the lead FFI must notify the IRS of the new status of a limited FFI or limited branch upon the termination of the limited FFI/branch transition period.

Observation: *As this protection afforded Model 2 FFIs does not seem to apply to PFFIs, it would appear that under the FFI agreement, a limited FFI or limited branch of an FFI that ceases to have limited status upon the expiration of the transitional period would taint FFIs within its group that are not in an Model 2 IGA country, but not FFIs that are in a Model 2 country. Similar relief for Model 1 FFIs was not specifically stated in the Notice.*

New concepts are announced that will be included in forthcoming regulations

The Notice announces new concepts within the FATCA regime. These concepts will be incorporated into

forthcoming regulations and generally include the following:

New FATCA classification involving NFFEs

The US Department of the Treasury (Treasury) intends to issue regulations creating a new category of excepted NFFEs called a direct reporting NFFE. Under this provision, an otherwise passive NFFE will not be required to disclose its substantial US owners to a withholding agent if it reports the information to the IRS on Form 8966, *Foreign Account Tax Compliance Act (FATCA) Report*.

Observation: *This provision seems to address the concern of certain NFFEs that the disclosure of US ownership in certain markets could impact their ability to compete or do business. It also appears that such NFFEs would benefit from not having to notify counterparties of a change in circumstances in the event that there was an ownership shift.*

Direct reporting NFFEs will be required to register with the IRS to obtain a GIIN and agree to comply with the modified provisions of the regulations with regard to reporting information about their substantial US owners on Form 8966. The Notice provides that the FATCA registration website will be modified to provide registration instructions for direct reporting NFFEs. Withholding agents and PFFIs will be required to verify the GIIN of a direct reporting NFFE against the list of GIINs published by the IRS.

In addition, Treasury intends to modify the FATCA regulations to provide that an entity can sponsor a direct reporting NFFE, in which case the sponsor will be required to perform the Form 8966 reporting with respect to a direct reporting NFFE's substantial US owners.

Transitional reporting of foreign reportable amounts paid to NPFFIs

Treasury intends to modify the transitional reporting rules to limit the requirement to report foreign reportable amounts paid to NPFFIs in calendar years 2015 and 2016, to situations where amounts are paid with respect to a financial account maintained for an NPFFI.

Reporting of foreign reportable amounts paid to NPFFIs will be required on Form 8966 rather than Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*. The Notice indicates that PFFIs will be permitted to either report foreign reportable amounts or all payments paid. If a PFFI is prohibited under local law from reporting foreign reportable amounts to an NPFFI without consent and is unable to obtain the consent of the NPFFI, the PFFI may report the aggregate number of accounts held by all such NPFFIs and the aggregate amount of foreign reportable amounts paid to such accounts.

Observation: *Under the modified transitional reporting requirement, foreign reportable amounts paid to NPFFIs that are not associated with a financial account will not be subject to the transitional reporting in 2015 and 2016.*

Coordination with Section 3406 backup withholding

Treasury intends to issue regulations providing that Section 3406 backup withholding will not be required on a reportable payment if FATCA withholding has been applied. However, backup withholding will continue to be applicable to a reportable payment where FATCA withholding does not apply (e.g., a reportable payment by a Model 2 FFI to a non-consenting US account). Alternatively, a PFFI may elect to satisfy its FATCA withholding

obligations with respect to accounts held by recalcitrant account holders that are known US persons through Section 3406 backup withholding.

The draft FFI agreement provides that a PFFI that elects to satisfy its withholding obligations on withholdable payments made to recalcitrant account holders that are known US persons through Section 3406 backup withholding, must report the reportable amounts on Form 1099. The PFFI must also file Form 945, *Annual Return of Withheld Federal Income Tax*.

In addition, the draft FFI agreement provides that withholding statements must include allocation information on the portion of a payment subject to backup withholding that is allocated to the FATCA withholding rate pool of recalcitrant account holders that are known US persons.

As a related matter, the draft FFI agreement makes it clear that for Model 2 FFIs, the exception from having to withhold on withholdable payments made to non-consenting US accounts is conditional and applies only if the conditions enumerated in the applicable Model 2 IGA are met. If the conditions are not met, the Model 2 FFI must treat the account holders as recalcitrant and withhold. In addition, Model 2 FFIs must generally withhold on withholdable payments made to NPFFIs regardless of whether they are account holders.

Model 2 FFIs must include non-consenting US accounts in its pooled reporting unless Chapter 3 withholding applies, or the non-consenting US account is a known US person that has been subjected to Section 3406 backup withholding.

Coordination with Chapter 61 Form 1099 reporting

Treasury intends to issue regulations under Chapter 61 providing that a

non-US payor that is a PFFI (including a Model 2 FFI) or a Model 1 FFI will satisfy its Form 1099 reporting requirements under Chapter 61 with respect to a US non-exempt recipient if the FFI reports the US non-exempt recipient account holder pursuant to the FFI agreement or applicable IGA. This includes situations where the FFI reports an account – such as a depository account with a balance or value that does not exceed \$50,000 – as a US account. However, Form 1099 reporting is still required to the extent that backup withholding is applied to the payment.

Observation: *The potential relief from having to perform Form 1099 reporting for US persons where FATCA reporting is performed is another factor that PFFIs and Model 1 FFIs will need to consider in determining whether to apply the de minimis account thresholds for account documentation.*

The draft FFI agreement provides that an FFI that elects to report on Form 1099 under Chapter 61 must file a Form 1099 each year regardless of whether a reportable payment is made. If no reportable payment is made, a Form 1099-MISC must be filed.

Section 953(d) entities

Treasury intends to modify the definition of a US person in the FATCA regulations to include a foreign insurance company that is not a specified insurance company and that makes a Section 953(d) election as a US person.

New responsibilities under the draft FFI agreement

Notification regarding the status of FFI group members

The FFI agreement defines an FFI group as an EAG that includes one or more PFFIs, or in the case of a Model

2 FFI, a group of related entities (as defined under a Model 2 IGA). The draft agreement provides that the lead FFI on behalf of an FFI group must update the FFI's FATCA status on the FATCA website within 90 days of a change affecting the FATCA status of any member of the FFI group, including any acquisition or sale of a member or when any member of the FFI group ceases to comply with its FATCA obligations. The Notice requires the lead FFI to monitor the FFI group information by accessing the FATCA registration website every six months, and if necessary, updating the on-line information with respect to any member.

PFFI withholding certificates

A PFFI must agree to furnish a valid withholding certificate to each withholding agent from which it receives a withholdable payment and to each PFFI or deemed-compliant FFI with whom the PFFI holds an account.

Observation: *This requirement was not expressly stated in the final regulations. Since there is no de minimis threshold associated with the requirement, it could prove overly burdensome in instances where furnishing withholding certificates becomes excessive.*

Expiration and termination of FFI agreement

The draft FFI agreement indicates that the FFI agreement will expire on December 31, 2016. Renewal must be performed on the FATCA website. Note that the FFI agreement can be renewed only upon the agreement of both the PFFI and the IRS.

A PFFI may seek to terminate the FFI agreement, but it must provide notice to the IRS through the FATCA registration website. If a PFFI's status is terminated, it must send notice of termination within 30 days to all

withholding agents and FFIs to which it has provided a withholding certificate.

The IRS may also provide a notice of termination to the PFFI which the PFFI may appeal within 90 days by sending a written notice explaining why the FFI agreement should not be terminated. If an appeal is lodged, the FFI agreement cannot be terminated until the appeal is decided.

The IRS will not terminate an FFI agreement unless there has been a significant change in circumstances or an event of default which the IRS determines warrants termination of the agreement. An event of default occurs if a PFFI:

- fails to perform any material duty or obligation required under the FFI agreement or the IRS determines that a PFFI has failed to substantially comply with the requirements of the FFI agreement
- fails to inform the IRS within 90 days of any significant change in circumstances, or
- is designated by one or more FFIs that are members of an FFI group as a lead FI, and the FFI fails, without reasonable cause, to inform the IRS within 90 days of an acquisition, sale, or change affecting the FATCA status of an FFI in the FFI group for which it is acting as lead FI.

Other miscellaneous clarifications

Expiration of documentation

The draft FFI agreement provides that a PFFI may rely on documentation until the expiration of such documentation or until there is a change in circumstances that affects the account holder or payee's claim of FATCA status. In addition, the draft

FFI agreement provides that if the PFFI is unable to obtain the required documentation within 90 days of the expiration date of the documentation or a change in circumstances, the PFFI must apply the presumption rules discussed below with respect to the account or payee until valid documentation is obtained upon which the FFI is permitted to rely.

Observation: *This is a departure from current rules under Chapter 3, under which an account would have to be treated as undocumented at the time a document expires.*

The draft FFI agreement also provides that a Model 2 FFI that applies the due diligence procedures described in Annex I of the applicable IGA may rely on documentation under the IGA until the expiration date or a change in circumstances.

Observation: *It appears that there will be expiration dates on documentation under the Model 2 IGA and that the 90-day rule for expiration of documentation and a change in circumstances does not appear to apply to a Model 2 FFI that follows Annex I.*

Application of presumption rules

The draft FFI agreement provides that PFFIs and Model 2 FFIs have to apply presumption rules in absence of documentation (whether due to failure to provide, expiration of prior documentation, or change in circumstances) until valid documentation is provided. However, following a change in circumstances, a PFFI may continue to treat otherwise valid documentation as valid and rely on such documentation until the earlier of 30 days following the change in circumstances or the date new documentation is obtained.

Additionally, a PFFI may choose to escrow amounts withheld after the date of a change in circumstances

until the earlier of the date that is 90 days after the date the first withholdable payment is made to the account following the change in circumstances or the end of the calendar year in which such withholdable payment is made.

Observation: *It is unclear how this 30-day rule will apply since the FATCA regulations apply a 90-day rule in this situation. It appears that the IRS and Treasury will need to provide additional guidance clarifying the application of this 30-day rule.*

Withholding on pre-existing accounts

The draft FFI agreement provides that FATCA withholding is not required with respect to preexisting accounts until the applicable time period has lapsed for identifying pre-existing accounts held by an NPFFI or a recalcitrant account holder.

Observation: *It is not clear if this provision is intended to apply in all cases. For example, in cases where an entity documents itself as a limited FFI prior to the termination of the applicable time period, one would expect FATCA withholding to begin immediately. Moreover, FFIs that are intermediaries or flow-through entities that are themselves preexisting account holders would likely expect their FATCA withholding agent (whether a PFFI or Model 2 FFI) to withhold when provided with the necessary instructions and required documentation before the termination of the applicable time period.*

Exception for exempt beneficial owners

As a general rule, each FFI within an FFI group must obtain a FATCA status of PFFI, registered deemed-compliant FFI, or limited FFI in order for any FFI in the group to not be treated as an NPFFI. However, the

Notice provides that exempt beneficial owners are not required to obtain one of those statuses. Accordingly, the FATCA status of an exempt beneficial owner will not adversely impact the FATCA status of another member of its EAG.

Observation: *The exception for exempt beneficial owners is welcome clarification particularly for entities such as sovereign wealth funds and pension funds which may have majority interests in investment entities.*

Certifications of compliance by responsible officer (RO)

The draft FFI agreement provides that no later than 60 days following two years after the effective date of the FFI agreement, the RO of the PFFI must make the certification described in the FATCA regulations regarding the FFI's completion of due diligence procedures for pre-existing accounts and regarding the absence of any formal or informal practices or procedures to assist account holders in avoiding FATCA. In addition, on or before July 1 of the calendar year following the certification period defined in the FATCA regulations, the RO of the PFFI must make the certification of internal controls described in the FATCA regulations or, when required, make the qualified certification under the regulations.

Adjustment for overwithholding and underwithholding

The draft FFI agreement provides that a PFFI may request a withholding agent to make an adjustment for amounts paid to the PFFI on which the withholding agent has overwithheld under FATCA by applying the procedures described in the FFI agreement. For example, a PFFI may request a withholding agent to repay the PFFI for any amount overwithheld, and for the withholding agent to reimburse itself under the

reimbursement procedures under the FATCA regulations, by making a request prior to certain reporting deadlines. Using set-off provisions in the regulations, a PFFI may instead request a withholding agent to repay the PFFI by applying the amount overwithheld under FATCA against any amount which otherwise would be required to be withheld under Chapter 3 or FATCA from income paid by the withholding agent to the PFFI.

There are special rules in the Notice with respect to adjustments for underwithholding that occur before and after Form 1042 is filed. If a PFFI knows that an amount should have been withheld under FATCA, the PFFI may either withhold from a future payment made pursuant to Chapter 3 or FATCA or satisfy the tax liability from property that it holds in custody for such person. The additional withholding or satisfaction must occur before the due date of the Form 1042. If a PFFI or the IRS determines that a PFFI has underwithheld tax for such year after the Form 1042 is filed, an amended Form 1042 must be filed to report and pay the underwithheld tax.

Treatment of QIs, WPs, and WTs

The Notice reiterates that qualified intermediary (QI), withholding foreign partnership (WP), and withholding foreign trust (WT) agreements in effect on or after June 30, 2014 are being modified to address FATCA requirements. The updated agreements will incorporate by reference the requirements of the FFI agreement (including the modifications to the terms of the FFI agreement that are applicable to a Model 2 FFI).

The Notice clarifies that Treasury intends to modify the FATCA regulations to provide that an NFFE that is acting as a QI, WP, or WT will not be treated as a passive NFFE. An NFFE that is acting as a QI and receiving withholdable payments on

behalf of a passive NFFE will be required under the updated QI agreement to report directly to the IRS information about the passive NFFE and its substantial US owners. Similarly, an NFFE that is a WP or WT will be required pursuant to the updated WP or WT agreement to report directly to the IRS information about its substantial US owners.

The takeaway

Notice 2013-69 should provide stakeholders a greater understanding of their obligations under FATCA, specifically with respect to FFI agreements. The critical question is how this guidance will impact their overall FATCA compliance plan, including changes to procedures and internal controls. For example, how will the branches of FFIs be treated pursuant to the new guidance? Will any passive NFFEs want to pursue direct reporting to the IRS? Will PFFIs want to elect to satisfy their FATCA withholding obligations for

recalcitrant account holders by imposing Section 3406 backup withholding instead?

As more guidance is released, stakeholders should re-evaluate their compliance plans or previously completed analyses. To recap, expected additional guidance under the Notice includes:

- updated regulations under Section 61 relating to Form 1099 reporting
- updated regulations under Section 3406 relating to backup withholding
- modified transitional reporting requirements with respect to payments of foreign reportable amounts made to NPFFIs
- updated FATCA regulations relating to direct reporting NFFEs or sponsored direct reporting NFFEs

- modified FATCA regulations relating to NFFEs that are QIs, WPs, or WTs
- modified FATCA regulations relating to the treatment of foreign insurance companies that make a Section 953(d) election
- updated Forms W-8 to incorporate and implement changes described in the Notice
- final FFI agreement.

Key milestones are approaching and the hope is that the additional guidance will be published with sufficient time for taxpayers to pursue appropriate actions. A critical date is July 1, 2014, which is the start of FATCA withholding. However, January 1, 2014 is the start of the final submissions for FATCA registration – a date quickly approaching prompting taxpayers to complete their legal entities analysis as soon as possible.

Let's talk

For more information on how FATCA and other information requirements might impact your organization, please contact the below PwC partners.

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