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Final FATCA Regulations Released

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The US Treasury Department has released the long-anticipated final FATCA regulations (the 'Regulations'), which build upon the foundation of the proposed regulations but contain some significant additions and modifications.

Non-US financial institutions and non-financial entities that have been waiting for the release of the Regulations before embarking in earnest on their FATCA compliance projects should now finally have enough information to begin preparing for this new US regime. Non-US financial institutions and non-financial entities, including banks, funds, trust companies, trusts, and charities should begin their preparations as soon as possible, if they have not already done so, to ensure that they are ready when the new US withholding provisions begin to phase in starting in January of 2014.

Background

FATCA will generally impose a new withholding tax of 30% on US source dividends, interest, and various other 'fixed, determinable, annual or periodic' payments as well as gross proceeds from the sale or disposition of assets that generate such payments (such as sales of US stock). This withholding tax will apply to payments to non-US financial institutions ('FFIs') that do not comply with certain identification and information reporting requirements regarding their US accountholders (including substantial US owners of non-US entities), and to non-US non-financial entities ('NFFEs') that do not report certain information directly to US withholding agents. However, both the Regulations and new bi-lateral intergovernmental agreements ('IGAs') except certain categories of entities from these identification and reporting obligations.

Key Differences from the Proposed Regulations

Treasury and the IRS adopted a three-fold response to the comments they received on the proposed regulations: (i) using a 'risk based' approach under which certain categories of low-risk entities should be eligible for excepted or deemed-compliant status; (ii) negotiating IGAs with a number of jurisdictions in order to address potential incompatibilities with the banking secrecy and data protection laws of those countries; and (iii) attempting to simplify and facilitate entering into an agreement with the IRS (the 'FFI Agreement') through an online registration process.

Harmonization of Implementation Deadlines with IGAs

As prior guidance indicated was the intention, the IRS extended certain implementation deadlines under the Regulations to harmonize these with the deadlines under the IGAs.

Attorney Advertising Material

All accounts in existence prior to January 1, 2014 will be treated as ‘preexisting accounts,’ and withholding agents will have until December 31, 2015 to document accountholders and payees that are not ‘prima facie FFIs.’

The effective date of FFI Agreements entered into with the IRS will be December 31, 2013 for all participating FFIs that apply prior to January 1, 2014. The first information reporting by participating FFIs, with respect to the 2013 and 2014 calendar years, will be due on March 31, 2015.

Withholding will not be required on ‘foreign passthru payments’ or on gross proceeds from sales or dispositions of property before January 1, 2017.

The ‘sunset’ date for the relief accorded to ‘limited’ branches and affiliates, by which all members of an expanded affiliated group will be required to be participating FFIs or deemed-complaint FFIs has not been extended, and remains December 31, 2015.

Trusts and Family Investment Entities

In a welcome change from the proposed regulations, certain trusts and family owned investment entities that primarily hold investment assets (and therefore might potentially have been FFIs) generally should instead be categorized as NFFEs provided the trustee and investment advisors are individuals. This is important as the compliance burden differs significantly depending on whether an entity is an FFI or an NFFE. NFFEs must only either certify to US withholding agents that they have no substantial US owners or provide the name, address, and US taxpayer identification number of each such substantial US owner, whereas FFIs (unless they are ‘Model 1 IGA’ FFIs) must enter into an FFI Agreement, comply with extensive due diligence and verification requirements, and provide substantial additional information to the IRS.

Further, a new procedure may assist certain trusts and entities not covered by an IGA and that are still treated as FFIs because they (i) primarily hold investment assets; and (ii) are ‘professionally managed’ -- meaning generally where trust companies (potentially including private trust companies), family offices, and other investment advisors play a role. In these instances, a new ‘Sponsoring/Sponsored FFI' mechanism may be available under which trusts and underlying entities should be ‘deemed compliant’ provided that the trust company is either itself a participating FFI or a ‘Model 1 IGA’ FFI and agrees to report on their behalf the information that the trust or family investment entity would have been required to report under an FFI Agreement.

Trusts and family investment entities covered by an IGA, where the definition of investment entity is determined consistently with FATF guidelines, may potentially be categorized as NFFEs under a different (and in some respects broader) test than under the Regulations. While this may be a significant benefit to certain trusts and family investment entities, it creates a potential divergence between the Regulations and ‘Model 1 IGA’ jurisdictions with respect to identifying substantial US owners of these entities. The

FATF guidelines appear to impose a 25% beneficial ownership threshold whereas the Regulations impose a 10% (or potentially, with respect to certain investment entities, a 0%) threshold. Another potential distinction arises with respect to the ‘controlling person’ definition under the IGAs, which may require different information to be reported under the Regulations and Model 1 IGAs (although under some Model 1 IGAs, the Partner jurisdiction may choose to allow FFIs to elect to apply the accountholder identification procedures specified in the Regulations, and under Model 2 IGAs this will generally be required).

Accounts held by Estates

The Regulations conform the treatment of accounts held by estates with the rules requiring that US persons report certain ‘specified foreign financial assets.’ Therefore, accounts held by estates are generally excepted from the definition of a financial account, and so are not subject to FATCA.

Investment Funds

As noted above, the Regulations substantially expand the scope of the term ‘investment entity’ to include entities whose gross income is primarily attributable to investing or trading in certain financial assets and that are managed by a management company. In addition, the Regulations treat any entity that holds itself out as a mutual fund, hedge fund, private equity fund, venture capital fund, leveraged buyout fund, or similar investment vehicle as an FFI. The examples in the Regulations also treat investment management and investment advisory companies as FFIs.

The Sponsoring/Sponsored FFI regime should also be available to certain investment funds, thereby potentially allowing investment managers to centralize FATCA compliance across a series of funds managed by the same investment management company.

The Regulations also clarify that an investment entity will be considered regulated, for the purposes of determining eligibility for treatment as a ‘Qualified Collective Investment Vehicle’ (‘QCIV’) or a ‘Restricted Fund’ (and therefore not subject to FATCA withholding), if either: (i) the investment entity is regulated in all countries in which it is registered and operates; or (ii) the investment entity’s manager is regulated with respect to the investment entity in all countries in which the investment entity is registered and operates.

Insurance Contracts and Insurance Companies

The Regulations provide a new *de minimis* exception from reporting for cash value insurance contracts valued below US$50,000, and clarify that certain insurance contracts may qualify as having a ‘definitive term’ by reference to the life expectancy of the insured and therefore may be eligible to be treated as ‘grandfathered’ obligations.

The Regulations provide that the term 'US Person' does not include insurance companies that have made an election to be taxed as a US insurance company under Section 953(d) unless that company is licensed to do business in a US state. Therefore, non-US insurance companies will generally be FFIs.

Retirement Funds and Retirement/Pension Savings Accounts

The Regulations relax the requirements in the proposed regulations and now exempt certain retirement funds from FATCA withholding even if the fund is not the beneficial owner of the payment. In addition, certain retirement savings accounts are now excluded from the definition of a financial account even where contributions are not limited to employer, employee, or government contributions.

Expanded 'Local FFI' Exception

The 'local bank' exception in the proposed regulations has been expanded to apply to insurance companies, credit unions, and investment entities, and these entities are now permitted to maintain a fixed place of business outside their countries of organization provided that this location is not advertised and provides only back office support functions. Certain forms of print, radio, or television advertising outside the country of organization are now also permitted, provided that advertising is primarily targeted within the country of organization and certain other conditions are satisfied.

The Regulations also add, as a condition for qualifying for the Local FFI exception, that an FFI not have policies or practices that discriminate against opening or maintaining accounts for US individuals resident in the local FFI country, underscoring that FFIs cannot simply rely on excluding US customers as a FATCA compliance approach.

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