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## FATCA Regulations Finally Arrive: A First Look

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On January 17, 2013, the U.S. Treasury Department (“U.S. Treasury”) and the Internal Revenue Service (“IRS”) released long-awaited final regulations on the Foreign Account Tax Compliance Act (“FATCA”).<sup>1</sup> The final regulations respond to industry concerns about the regulatory burden of FATCA by adopting a risk-based approach that is designed to eliminate unnecessary burdens, and coordinate with the practices and obligations under intergovernmental agreements (“IGAs”) that many foreign governments have entered into, or are negotiating, with the U.S. Treasury. The final regulations confirm the phased-in timelines for due diligence, reporting and withholding; expand and clarify the scope of grandfathered obligations and non-financial foreign entity (“NFFE”) payments not subject to withholding; expand the definition of foreign financial institutions (“FFIs”) and exempted entities; and streamline the registration and compliance procedures for FFIs.

Below is a list of highlights from the final FATCA regulations. K&L Gates will provide more in-depth analysis in the coming weeks.

### Highlights of the FATCA Final Regulations

- **Deadlines**
  - Participating FFIs generally must enter into FFI agreements with the IRS by October 25, 2013 to ensure that they appear on the December 2013 FFI list (and thus avoid withholding starting on January 1, 2014). Each participating FFI will receive a Global Intermediary Identification Number (“GIIN”).
  - Participating FFIs and withholding agents have until December 31, 2015 to document account holders and payees that are not prima facie FFIs.
  - First information reports for 2013 and 2014 calendar years are due no later than March 31, 2015.
  - In general, withholding will apply starting in 2014 to payments of U.S.-source dividends, interest, royalties, and other passive income (referred to as “FDAP income”) to non-participating FFIs and NFFEs that fail to provide required certifications.
  - Foreign passthru payments and gross proceeds from sales or dispositions of property occurring before January 1, 2017 are exempt from withholding.

<sup>1</sup> Further background on FATCA can be found in our prior alert: [<http://www.klgates.com/Next-Phase-of-FATCA-Guidance-Arrives-with-Proposed-Regulations-and-Announcement-of-Possible-Intergovernmental-Approach-03-12-2012>].

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- Definition of FFI
  - FFIs include banks, custodians, investment entities, and certain insurance companies. The definition of investment entity has been aligned with the definition in the IGAs so that it includes certain foreign entities that invest, administer, or manage funds or money on behalf of other persons, even if these entities are not themselves investment funds. For such a foreign adviser or administrator to be treated as an FFI, at least 50% of its gross income for the preceding three years must be earned as a result of advising or administering investment entities.
  - Passive entities that are not professionally managed (*i.e.*, not managed by a depository institution, custodial institution, investment entity, or insurance company that qualifies as a financial institution) are generally treated as passive NFFEs rather than FFIs.
  - Certain members of nonfinancial groups, such as holding companies, treasury centers, and captive finance companies, are excepted from FFI status under certain circumstances.
  - A new exception for inter-affiliate FFIs (generally, entities whose activities are entirely within their financial group) has been created.
  - A sponsoring entity, such as an investment adviser or holding company, may undertake to fulfill the due diligence and reporting responsibilities of one or more sponsored FFIs.
- Due Diligence Requirements
  - In general, the due diligence requirements have been relaxed.
  - For offshore obligations, an FFI may retain a notation in its files regarding the documentary evidence examined, rather than retaining a copy of the documentary evidence (unless required to do so under relevant anti-money laundering (“AML”) rules).
  - In certain cases, a withholding agent may rely on a pre-FATCA Form W-8 instead of an updated withholding certificate for preexisting account holders.
  - Withholding agents can rely on documentary evidence instead of Form W-9 to establish an entity’s status as a U.S. person. Withholding agents can also rely on an “eyeball test” and treat certain entities as other than specified U.S. persons if they have “incorporated,” “corporation,” or an indication of status as a financial institution in their names.
  - With respect to entities, a withholding agent may rely on documentation collected by third-party data providers subject to certain conditions, so long as the withholding agent determines that the documentation is reliable.
  - The final regulations contain new standards on a withholding agent’s reason to know a payee’s status as a foreign person, limit review for particular documentation, especially with regard to preexisting obligations, and provide guidance on when a payee has made a reasonable explanation regarding the presence of U.S. indicia.
  - Certifications regarding completion of required due diligence for preexisting accounts must be made no later than 60 days following the date that is two years after the effective date of the FFI agreement. A responsible officer may also make a qualified certification if he or she is unable to make the full required certification.
  - An FFI agreement will not automatically terminate because of the FFI’s failure to comply. Rather, the participating FFI will have an opportunity to remediate the default.

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- A participating FFI, reporting Model 1 IGA FFI, or U.S. financial institution may agree to establish and maintain a consolidated compliance program and perform a consolidated periodic review on behalf of one or more FFIs in the same expanded affiliate group.
- Grandfathered Obligations
  - Grandfathered obligations include all obligations outstanding on January 1, 2014, and any associated collateral.
  - The relevant date for a debt obligation is the issuance date, which will change if a significant modification occurs.
  - The relevant date for non-debt obligations is the date a legally binding agreement is executed.
  - If future regulations relating to dividend equivalent payments or foreign passthru payments create withholdable payments, those obligations are grandfathered if they are outstanding at any point prior to six months after the implementing regulations are published.
- Preexisting Accounts
  - In general, the final regulations did not change the thresholds for accounts subject to due diligence.
  - All preexisting accounts held by individuals with a balance less than \$50,000 are exempt from due diligence review (\$250,000 for entities and accounts that are cash value insurance and annuity contracts).
  - For individual accounts with balances of no more than \$1 million, due diligence is limited to determining the presence of U.S. indicia in electronically searchable information (as defined in the final regulations). Due diligence for passive NFFEs can rely on AML due diligence to identify substantial U.S. owners.
  - A new account of a preexisting customer can be treated as a preexisting obligation if the withholding agent or FFI maintaining the account treats the new obligation and prior obligation as one obligation for AML due diligence purposes, for aggregating balances, and for applying the standards of knowledge under Chapter 4.
  - The final regulations set forth rules on how a participating FFI should treat accounts received from another entity in a merger or bulk acquisition transaction.
- Recalcitrant Account Procedures
  - For new accounts, an account holder generally will be considered recalcitrant if it does not provide the required information within 90 days of the account opening or, if earlier, the date a withholdable payment or foreign passthru payment is made to the account.
  - If foreign law prohibits a participating FFI from fulfilling its withholding obligations, the participating FFI must close the account within a reasonable time, or, if local law prohibits closing the account, the participating FFI must block (or freeze) or transfer the account.
  - If a participating FFI is prohibited by foreign law, absent a waiver, from reporting information on a U.S. account, the participating FFI must request a waiver of foreign law. If a waiver is not obtained within a reasonable amount of time, the participating FFI must close or transfer the account.

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Currently, FFIs in countries that have signed a Model 1 IGA are deemed to comply with the final FATCA regulations. FFIs in countries that have signed a Model 2 IGA must comply with the final FATCA regulations, except as modified by the IGA. The U.S. previously signed IGAs with seven countries: Denmark, Ireland, Mexico, Norway, Spain, Switzerland, and the United Kingdom, and has indicated that it is in discussions with more than 50 other countries and jurisdictions.

Despite the heft of the final regulations, U.S. Treasury and the IRS still must complete the following additional guidance on FATCA:

- a final Form W-8BEN for entities (Form W-8BEN-E);
- a revised Form W-8BEN for individuals;
- a new Form 8966 (FATCA Report), which will establish what information regarding financial accounts withholding agents and FFIs must report to comply with their reporting obligations;
- a revised version of Form 1042 (Annual Withholding Tax Return for U.S. Source Income of Foreign Persons);
- a revised Form 1042-S (Foreign Person's U.S. Source Income Subject to Withholding);
- a new Revenue Procedure setting out the terms of an FFI agreement, which would coordinate an FFI's obligations with chapter 3 obligations and with the provisions of any applicable IGA (including provisions relating to termination, renewal, and modification of the agreement); and
- the FATCA Registration Portal, which will be the primary means for FFIs to interact with the IRS to complete and maintain their chapter 4 registrations, agreements, and certifications.

Financial institutions have little remaining time to prepare for the implementation of FATCA. Accordingly, financial institutions are strongly encouraged to carefully review the final FATCA regulations, determine the applicability or impact of any IGAs, and prepare a FATCA compliance program. K&L Gates will provide additional analysis of the final regulations in the coming days, and will continue to monitor developments under FATCA and the IGAs. Please contact any of the authors of this alert or your K&L Gates relationship partner with any questions.

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