

ClientAlert

Tax

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Treasury Issues Final FATCA Regulations

Introduction

On January 17, 2013, the Department of the Treasury ("the Treasury") and the Internal Revenue Service (the "Service") issued final regulations (the "Regulations") under Sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended (the "Code")—commonly referred to as the Foreign Account Tax Compliance Act ("FATCA"). The Regulations represent a significant departure from the proposed regulations that were issued on February 8, 2012 (please see our February 2012 Client Alert for a discussion of the proposed regulations). The Regulations do not address all of the issues raised by FATCA (including, in particular, the definition of "foreign passthru payments"). This Alert summarizes a number of the principal changes in the Regulations that may be relevant in Bank Finance, Capital Markets and Private Equity transactions. This Alert is the first in a series. Subsequent alerts will be tailored to affected industry groups.

Intergovernmental Agreements

In February, the Treasury, in acknowledgement of the serious conflict of law issues FATCA raised, announced a framework for intergovernmental cooperation in effecting FATCA's aims. Since February, the Treasury and the Service have introduced two model intergovernmental agreements ("IGAs") to ensure effective implementation of FATCA. The Regulations have been drafted to complement and coordinate with these agreements.

There are two different model agreements. Model 1 is bilateral and reciprocal. It provides for the exchange of information at the ministry level to allow taxing authorities in the US and its partner jurisdictions to determine whether residents of the US and its partner jurisdictions are maintaining unreported financial accounts. The Model 1 IGA includes a policy commitment for the US to pursue regulations and support legislation that would enable the US to provide this information to its partner jurisdictions. A Foreign Financial Institution ("FFI") located in a jurisdiction that has a Model 1 IGA is deemed to have complied with FATCA's withholding and reporting requirements while enabling it to comply with local laws.

Model 2 is nonreciprocal. FFIs located in a jurisdiction with a Model 2 agreement must still enter into FFI Agreements with the Service and comply with the Regulations except to the extent modified by the Model 2 IGA. Model 2 agreements will be less burdensome for the local authorities but not as beneficial for the FFI.



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To date, the United Kingdom, Mexico, Denmark, Ireland, Switzerland and Spain have signed or initialed Model 1 agreements. Treasury is reported to be engaged in discussions with more than 50 countries and jurisdictions to conclude IGAs. No Model 2 (nonreciprocal) agreements have been concluded.

The Regulations, in addition to conforming to and dovetailing with the IGAs, contain several important changes from the proposed regulations. These are outlined below.

Expansion of Grandfathering Rule

The Regulations expand the grandfathering rule for certain obligations:

- *Obligations outstanding on January 1, 2014.* Generally, all obligations that are outstanding on January 1, 2014, are exempt from FATCA withholding. For debt obligations, the Regulations determine the date the obligation is outstanding based on the issue date of the debt. The date a non-debt obligation, such as a swap or derivative, is outstanding is the date a legally binding agreement setting forth all material terms of the obligation is executed. The grandfathering rules do not apply to equity instruments.
- *Certain payments that are equivalent to dividends.* Any obligation that gives rise to withholdable payments solely because the obligation is treated as giving rise to a dividend equivalent is exempt from FATCA if the obligation is executed on or before the date that is six months after the date on which obligations of its type are first treated as giving rise to dividend equivalents under administrative guidance promulgated pursuant to Code Section 871(m).
- *Foreign passthru payments.* An obligation will not give rise to a "foreign passthru payment" if it is executed on or before the date that is six months after the date this term is defined in subsequent amendments to the Regulations.
- *Collateral securing a grandfathered obligation.* Any agreement that requires a secured party to make payments with respect to, or repay, collateral securing one or more grandfathered obligations (even if the collateral is not itself a grandfathered obligation).
- *Qualified reopening.* Debt issued in a qualified reopening will be treated as a grandfathered obligation if the original debt was issued before January 1, 2014.

Modifications to the Definition of Financial Institution

The Regulations modify the definition of "financial institution" in several ways. (As a reminder, FATCA generally applies to US source payments to "foreign financial institutions")

For example:

- A "depository institution" must now accept deposits and engage in one or more enumerated banking activities before it will be treated as a financial institution.
- The definition of "investment entity" (a sub-category of financial institution) has been modified to exclude passive, noncommercial investment vehicles, including trusts that do not undertake investment activities on behalf of customers. The Regulations generally adopt the definition of "investment entities" found in the Model IGAs. Under the Regulations, an "investment entity" includes any entity that primarily conducts as a business on behalf of customers: (1) trading in an enumerated list of financial instruments; (2) individual or collective portfolio management; or (3) otherwise investing, administering, or managing funds, money, or certain financial assets on behalf of other persons (such activities, "Investment Activities"). In addition, an investment entity includes any entity whose gross income is primarily attributable to investing or trading in financial assets and which is managed by an entity that conducts Investment Activities, whether or not it has "customers". Passive investment vehicles that do not fall within the definition of an investment entity are generally treated as non-financial foreign entities ("NFFEs") rather than FFIs.

More Institutions Exempt From FATCA Reporting

Certain FFIs are generally exempt from the requirement to enter into a full-blown FFI Agreement with the IRS. The Regulations broaden these categories in the following manner.

- *New categories of deemed-compliant FFIs.* The Regulations introduce new categories of deemed-compliant FFIs for certain credit card issuers, sponsored FFIs and limited-life debt investment entities (see below).
- *Treatment of Retirement Funds.* The deemed-compliant category for retirement funds has been combined with the exempt beneficial owner category for a retirement fund. The Regulations also broaden the treaty-qualified retirement fund category and add a new category for funds formed pursuant to pension plans that would meet the requirements of section 401(a), other than the requirement that the plan be funded by a trust created or organized in the United States.
- *Exempt beneficial owner category expanded for governments.* The Regulations expand the exempt beneficial owner category for foreign governments, international organizations and foreign central banks of issue. The definition of international organization has been expanded and is no longer limited to public international organizations in which the United States participates pursuant to a treaty or any act of Congress.

Additionally, exempt beneficial owners may engage in certain commercial activities without losing the benefit of exempt beneficial owner status if such activities are at the direction of other exempt beneficial owners and are consistent with the purpose of the entity.

- *Limited life debt investment vehicles.* In recognition of the fact that certain trust vehicles formed for the purpose of investing in a limited type of debt obligation with the intent to hold such security until maturity or liquidation may not be able to register the vehicle as a participating FFI given the limited powers of the trustee, the Regulations treat these limited life debt investment vehicles as certified deemed-compliant FFIs prior to January 1, 2017. In general, this exception is available to a FFI that is a collective investment vehicle formed pursuant to a trust indenture that was in existence as of December 31, 2011, that is required, pursuant to its organizational documents to liquidate on or prior to a set date provided that payments made to investors in the vehicle clear through certain types of US or FATCA compliant clearing organizations.
- *Sponsored FFIs.* The Regulations allow an FFI to sponsor another entity so that it becomes a registered deemed-compliant FFI. The sponsor must undertake all of the FATCA obligations of a participating FFI on behalf of the entity it sponsors.
- *Intergovernmental agreements.* The definition of exempt beneficial owner has been expanded to include any such person identified in an intergovernmental agreement.

Documentation

The Regulations lessen the documentation requirements to make compliance less expensive and more manageable. Four examples are noteworthy.

First, the Regulations permit a withholding agent to rely upon documentary evidence obtained with respect to the payee, in lieu of a Form W-9, in order to establish the entity's status as a US person and rely on the "eyeball test" to determine (to the extent applicable) the payee's status as other than a specified US person under FATCA.

Second, a withholding agent may rely on a Form W-8 obtained before 2013 for payments made prior to January 1, 2017, without seeking an updated form.

Third, the Regulations allow the financial institution to rely on forms other than the ones produced by the IRS. These forms may be both prepared in and filled out in a foreign language, provided the withholding agent furnishes the IRS with a translated version upon request. Such substitute forms must contain the same certifications as the official IRS form to the extent relevant.

Finally, the regulations permit a new account of a customer that has a preexisting account to be treated as a preexisting account, provided that the withholding agent or FFI maintaining the account also treats the new account and the prior obligation as one obligation for purposes of applying AML due diligence, aggregating balances, and applying the standards of knowledge for purposes of FATCA.

Effective Dates

The following table sets out the dates at which various aspects of FATCA take effect.

2013	2014	2015	2016	2017
July 15: Registration of FFIs with the IRS begins	January 1: Withholding on US source income begins	March 31: Reporting deadline for 2013 and 2014 years		January 1: Withholding on US source gross proceeds begins
October 25: FFIs must register by this date to be on 12/31/13 list of participating FFIs	January 1: Requirement to implement new account onboarding procedures for US withholding agents, Participating FFIs and Registered and Deemed-Compliant FFIs			January 1: Withholding on "passthru" payments begins on later of this date or six months following publication of regulations defining foreign passthru payments
December 31: Last date by which most "grandfathered obligations" may be issued				

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