

LOWENSTEIN SANDLER PC CLIENT ALERT

BUSINESS TAX COUNSELING & STRUCTURING

ATTORNEY ADVERTISING

IRS ISSUES NEW TIMELINE FOR IMPLEMENTATION OF FATCA

By: Brian A. Silikovitz, Esq., Richard J. Horne, Esq., and Isaac Hirsch, Esq.

August 2011

The IRS has issued a new timeline for implementing the onerous requirements imposed on foreign financial institutions (including foreign hedge funds and private equity funds) by the Foreign Account Tax Compliance Act ("FATCA").

Subject to certain grandfathering provisions, FATCA reporting and withholding was to begin on January 1, 2013. However, after discussions with financial institutions and foreign governments, the Internal Revenue Service ("IRS") has issued Notice 2011-53, which provides for a phased implementation of the FATCA requirements.

FATCA was enacted in March 2010 in an effort to combat tax avoidance by U.S. taxpayers through the use of offshore accounts. FATCA requires "foreign financial institutions" ("FFIs") to enter into an agreement (an "FFI Agreement") with the IRS to comply with verification and due diligence procedures and to report information about financial accounts held by U.S. taxpayers and foreign entities with one or more substantial U.S. owners. To encourage compliance by foreign financial institutions, FATCA imposes a 30% withholding tax on certain payments made to FFIs that do not enter into FFI Agreements with the IRS.

The term "FFI" includes any foreign entity that (A) accepts deposits in the ordinary course of a banking or similar business; (B) as a substantial portion of its business, holds financial assets for the account of others; or (C) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities. Accordingly, most foreign investment vehicles, including foreign hedge funds, private equity funds and venture capital funds, would be classified as FFIs for FATCA purposes.

Per the FFI Agreement, a participating FFI must agree to do the following:

- obtain such information regarding each holder of each account maintained by the FFI as is necessary to determine which (if any) of such accounts are U.S. accounts;
- comply with such verification and due diligence procedures as the IRS may require with respect to the identification of U.S. accounts;
- report on an annual basis certain information with respect to any U.S. account maintained by such FFI, including: (1) the name, address,

and taxpayer identification number ("TIN") of each account holder who is a specified U.S. person; (2) the name, address, and TIN of each substantial U.S. owner of any account holder that is a U.S.-owned foreign entity; (3) the account number; (4) the account balance or value; and (5) the gross receipts and gross withdrawals or payments from the account;

- deduct and withhold 30% from certain payments (i.e., any "withholdable payment" (defined below) or other payment attributable to a withholdable payment) that is made by the FFI to (1) a recalcitrant account holder (generally any account holder who fails to comply with reasonable requests for specific information to determine if such holder is a U.S. person or who fails to provide a waiver of any foreign law that would prevent the FFI from otherwise reporting the necessary information to the IRS), (2) another FFI that does not enter into an agreement with the IRS, or (3) another FFI that has made an election to be withheld upon;

BUSINESS TAX COUNSELING & STRUCTURING

- comply with requests by the IRS for additional information with respect to any U.S. account maintained by such FFI; and
- obtain a waiver (or close the account) in any case where a foreign law would, but for a waiver, prevent the reporting of any required information.

The 30% withholding tax for noncompliance applies to “withholdable payments,” which term includes any U.S. source payments made to an FFI of interest (including any original issue discount and any “portfolio interest”), dividends, rents, compensation and other fixed or determinable annual or periodical gains, profits, and income. Withholdable payments also include any gross proceeds from the sale or other disposition of any property of a type that can produce U.S. source interest or dividends, including repayments of principal on a loan. Withholdable payments do not, however, include income that is effectively connected with a U.S. trade or business.

FATCA reporting and withholding was to begin on January 1, 2013 (grandfathering provisions apply to fixed-term obligations other than equity outstanding as of March 18, 2012). Under Notice 2011-53,

however, implementation will be phased in as follows:

- Withholding on U.S. source dividends and interest paid to nonparticipating FFIs will begin on January 1, 2014, and withholding on all withholdable payments (including on gross proceeds) will begin on January 1, 2015.
- An FFI must enter an agreement with the IRS by June 30, 2013, to ensure that it will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding. The IRS will begin accepting FFI Agreements through the IRS’s electronic submissions process no later than January 1, 2013. An FFI agreement entered into prior to July 1, 2013, will be effective July 1, 2013.
- A participating FFI will be required to put in place account-opening procedures to identify U.S. accounts among accounts opened on or after the effective date of its FFI Agreement. For preexisting accounts, due diligence procedures must be completed within one or two years of the effective date of the FFI Agreement, depending on the type of account.

- Reporting requirements will begin in 2014 (based on calendar year 2013 balances) and will be significantly simplified for the first year. Initial FATCA reports will be due September 30, 2014, for accounts that have been identified as U.S. accounts by June 30, 2014.

Notice 2011-53 indicates that Treasury and the IRS anticipate issuing proposed regulations by the end of 2011 and final regulations by the summer of 2012. Draft versions of the FFI Agreement and reporting forms to be used by participating FFIs are expected to be released by the IRS in the summer of 2012.

We will continue to monitor developments in this area, including the issuance of guidance by Treasury. Please contact any of the Lowenstein Sandler attorneys listed for further information.

Brian A. Silikovitz, Esq.
973 597 2562
bsilikovitz@lowenstein.com

Richard J. Horne, Esq.
646 414 6854
rhorne@lowenstein.com

Isaac Hirsch, Esq.
973 597 6318
ihirsch@lowenstein.com

Lowenstein Sandler makes no representation or warranty, express or implied, as to the completeness or accuracy of this Client Alert and assumes no responsibility to update the Client Alert based upon events subsequent to the date of its publication, such as new legislation, regulations, and judicial decisions. Readers should consult legal counsel of their own choosing to discuss how these matters may relate to their individual circumstances.

www.lowenstein.com

New York
1251 Avenue of the Americas
New York, NY 10020
212 262 6700

Palo Alto
590 Forest Avenue
Palo Alto, CA 94301
650 433 5800

Roseland
65 Livingston Avenue
Roseland, NJ 07068
973 597 2500