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## Highlights of Proposed Regulations Issued Under FATCA and Multijurisdiction Plan for Information Sharing

On February 8, 2012, Treasury and the IRS issued comprehensive proposed regulations (Proposed Regulations) that would, when finalized, implement the Foreign Account Tax Compliance Act (FATCA), which was enacted in March 2010. Notably, the Proposed Regulations delay the implementation of several FATCA provisions.

The FATCA provisions are intended to combat tax avoidance by U.S. taxpayers that use foreign accounts by imposing certain information reporting and withholding obligations on foreign financial institutions (FFIs), such as banks, investment funds, investment brokerages and insurance companies. Very generally, FATCA imposes 30 percent withholding on certain U.S.-source payments and payments of gross proceeds from the disposition of property that can produce such payments (“withholdable payments”) made to an FFI unless the FFI enters into an “FFI agreement” with the IRS to identify its U.S. account holders and to report to the IRS information about those accounts. These “participating FFIs” also are required to withhold 30 percent of “passthru payments” to nonparticipating FFIs and to account holders that fail to provide the required information (“recalcitrant account holders”).

FATCA also requires 30 percent withholding on withholdable payments to nonfinancial foreign entities (NFFE) when the payment is beneficially owned by a NFFE, unless the NFFE provides the payor with information (that the payor must report to the IRS) regarding its substantial U.S. owners or certifies that it does not have any such owners.

The Proposed Regulations modify and expand on prior guidance in the following respects:

- Expanded Definition of “Grandfathered” Obligations.** As enacted, FATCA includes a grandfathering rule for payments with respect to obligations outstanding on March 18, 2012. The Proposed Regulations expand the scope of this rule by excluding from FATCA withholding payments made under an obligation outstanding on January 1, 2013, and any gross proceeds from the disposition of such an obligation. As a result, most debt securities and loans advanced or committed to prior to that date, as well as derivative transactions entered into prior to such date, will not be subject to FATCA withholding. As under prior guidance, this exclusion does not apply to any legal agreement or instrument that is treated as equity for U.S. tax purposes or any legal agreement that lacks a stated expiration or term (e.g., a revolver without a stated maturity date). In addition, any material modification of an outstanding obligation after January 1, 2013, will subject payments with respect to those obligations to the FATCA rules.
- Phase-in of Passthru Payment Withholding.** The “passthru payment” rules target payments made by an FFI to a nonparticipating FFI that are either withholdable payments or that are not withholdable payments but are attributable to withholdable payments earned by that FFI. The passthru payment rules are intended to prevent nonparticipating FFIs from using participating FFIs as “blockers” (i.e., investment intermediaries) to avoid the application of FATCA on its U.S. investments. Under the statute, the rules could apply not only to U.S.-source payments but also to many different types of foreign-source payments made by any FFI

that holds U.S. assets. Under the Proposed Regulations, passthru payments are divided into two categories — withholdable payments and “foreign passthru payments.” Although prior guidance proposed passthru payment rules that essentially required a quarterly calculation of the ratio of the payor’s U.S. assets to total assets as a way of defining the extent of withholding on foreign passthru payments, the Proposed Regulations abandon that unpopular approach and instead implement the passthru payment regime in two steps.

- For withholdable payments: Beginning on January 1, 2014, FFIs will be required to withhold on withholdable payments (but not foreign passthru payments) and to report on the aggregate amount of certain payments to each nonparticipating FFI.
- For foreign passthru payments: Beginning no earlier than January 1, 2017, withholding will be required with respect to foreign passthru payments, the definition of which will be contained in future guidance.

The preamble expresses Treasury’s commitment to work with FATCA partner countries to develop practical alternatives to passthru payment withholding.

- **Definition of Financial Account.** Participating FFIs must identify and report information on all financial accounts held by certain U.S. persons. The Proposed Regulations refine the definition of “financial account” to focus on traditional bank, brokerage and money market accounts, as well as interests in investment vehicles (including insurance contracts with an investment component). The revised definition excludes most debt and equity securities issued by banks, dealers and insurance companies; certain savings accounts (including both retirement and pension accounts and nonretirement savings accounts); and insurance contracts that provide pure insurance protection.
- **Procedures to Identify U.S. Accounts.** The Proposed Regulations provide separate procedures for identifying U.S. account holders with respect to pre-existing and new accounts, and to individual and entity accounts. In response to criticism of the procedures proposed in prior guidance, however, the Proposed Regulations rely primarily on electronic reviews of pre-existing individual accounts, except in certain cases where the balance of an individual account exceeds \$1 million, in which case a limited manual review is required. With respect to pre-existing entity accounts, FFIs may rely on information gathered pursuant to anti-money laundering/“know your customer” rules. In addition, the Proposed Regulations exclude reviews of pre-existing individual accounts with a balance of \$50,000 or less, certain cash-value insurance contracts held by individuals with a value of \$250,000 or less, and certain entity accounts with a balance of \$250,000 or less. For new individual and entity accounts, the Proposed Regulations generally do not require an FFI to make significant modifications to the information collected on customer intake, other than with respect to account holders identified as FFIs, as passive investment entities, or as having U.S. indicia. Supplementing prior guidance, the Proposed Regulations require a responsible officer of a participating FFI to make certain certifications regarding the completion of due diligence procedures and the absence of any practices in place at any time since August 6, 2011, that would serve to assist account holders in the avoidance of FATCA obligations. External audits like those currently received by qualified intermediaries (QIs) will not be required. Moreover, the “private banking” review procedures included in prior guidance, which had been subject to some criticism, have been eliminated.

- **Transitional Rules for Affiliated Groups.** To be a participating FFI, all members of the FFI's expanded affiliated group also must comply with the FFI agreement requirements. Recognizing that certain jurisdictions have laws that prohibit an FFI's compliance with certain FATCA provisions, the Proposed Regulations provide that until January 1, 2016, an FFI affiliate or branch in such a jurisdiction (limited FFI) will not prevent the other FFIs in its expanded affiliated group from entering into an FFI agreement with the IRS. The limited FFI must comply with certain due diligence and recordkeeping requirements. After this transition period, all FFIs that are members of an expanded affiliated group must be participating or deemed-compliant FFIs in order for any FFI in that group to become a participating FFI.
- **Expanded Categories of Deemed-Compliant FFIs.** The FATCA rules allow certain FFIs to be treated as "deemed-compliant" so as to avoid withholding without entering into an FFI agreement. Under the Proposed Regulations, deemed-compliant FFIs can either be "certified" (*i.e.*, able to claim deemed-compliant status by providing to the payor a certified revised Form W-8) or "registered" (*i.e.*, deemed compliant after registering as such with the IRS and satisfying specified procedural requirements). A third category, "owner-documented FFIs" (*i.e.*, FFIs that provide documentation on their U.S. owners), can also avoid entering into FFI agreements under certain, more limited, circumstances. Certified deemed-compliant FFIs generally include certain small local banks, retirement funds and nonprofit organizations. Registered deemed-compliant FFIs include banks, brokers and financial advisors with local jurisdiction clients, nonreporting members of participating FFI groups, and certain restricted investment funds, all of which must have procedures in place to prevent participation by U.S. investors. Registered deemed-compliant FFIs also include certain qualified investment vehicles. Thus, while the Proposed Regulations expand the category of deemed-compliant FFIs from prior guidance, most global institutions with multinational investors will need to become participating FFIs and enter into FFI agreements to avoid withholding. The Proposed Regulations provide significant detail as to the category of retirement plans that can be deemed compliant. The Proposed Regulations do not create a deemed-compliant category for insurance companies participating only in a local market.
- **Extension of Transition Period for Information Reporting Obligations.** FATCA requires participating FFIs to report the name, address, taxpayer identification number, year-end account balance and payments (income and gross proceeds) made with respect to all U.S. accounts. In response to requests for additional time to build the systems necessary for information reporting under FATCA, the Proposed Regulations delay FFI reporting obligations with respect to *income* paid to U.S. accounts until 2016 (for income earned in 2015) and with respect to *gross proceeds* paid to U.S. accounts until 2017 (for proceeds received in 2016).
- **QIs, Withholding Foreign Partnerships (WPs), and Withholding Foreign Trusts (WTs).** QIs, WPs and WTIs are foreign entities that have agreed to be subject to the withholding and reporting provisions (*i.e.*, nonresident alien and backup withholding) otherwise applicable to U.S. withholding agents. The preamble to the Proposed Regulations contemplates that QIs, WPs and WTIs also will be required to fulfill the reporting and withholding requirements of a participating FFI.

The Proposed Regulations are proposed to be effective on the date of issuance of the rules as final regulations. Comments on the Proposed Regulations must be submitted by April 30, 2012.

With the issuance of the Proposed Regulations, Treasury released a joint statement with France, Germany, Italy, Spain and the United Kingdom (each, a “partner country”) that outlines an intergovernmental approach to implementing the FATCA provisions. Under the proposed approach, each partner country would agree to collect information on U.S. accounts held by its financial institutions and transfer that information to the United States. In return, the United States would agree to eliminate most of the FATCA obligations with respect to FFIs in the partner country and require U.S. financial institutions to collect and remit information (which the IRS would forward to the partner country) with respect to accounts held by residents of the partner country. It is unclear whether this approach meaningfully would reduce the due diligence and reporting requirements of FFIs in partner countries. It also is unclear whether this approach would ultimately lead to expanded information reporting by U.S. financial institutions (*e.g.*, on portfolio interest earned by non-U.S. persons and/or reporting of account balances on foreign accounts).

FFIs will be able to register as participating FFIs or deemed-compliant FFIs through an online system that will become available by January 1, 2013. Other forthcoming guidance will include a draft model FFI agreement and draft revised forms (including Form W-8); changes to the QI, WP and WT requirements; and coordinating changes to the nonresident alien and backup withholding definitions and procedures.

Please call with any questions you have about this guidance.