

Treasury and IRS Move to Implement FATCA as 2014 Start Date Approaches

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On October 29, 2013, the IRS issued Notice 2013-69 as the next step in implementing far-reaching legislation commonly known as the Foreign Account Tax Compliance Act (FATCA).

Congress enacted FATCA in 2010 as part of the HIRE Act to combat perceived tax evasion by U.S. persons through the use of overseas accounts. FATCA requires foreign financial institutions (FFIs) — defined broadly to include not only foreign banks but other offshore entities such as foreign investment funds — to enter into agreements with the IRS to report information about the holdings of U.S. taxpayers or face significant withholding taxes. The Treasury Department has delayed the start dates of FATCA several times to give FFIs more time to comply with FATCA's substantial administrative burdens.

In addition, the Treasury has been working to address local law impediments, such as bank secrecy laws, through intergovernmental agreements (IGAs) with different countries.¹ Last year, the Treasury published two versions of model IGAs. The Model 1 IGA requires FFIs resident in the relevant country to report all FATCA-related information to their own governmental agencies, which in turn report the information to the IRS. Some Model 1 IGAs are reciprocal, requiring the U.S. to provide certain information about residents of the Model 1 country to the Model 1 country in exchange for the information that country provides to the United States. An FFI covered by a Model 1 IGA does not need to enter into an FFI agreement with the IRS. The second version — the Model 2 IGA — requires FFIs to report information directly to the IRS. Certain FFIs covered by Model 2 IGAs will enter into an FFI agreement with the IRS (modified to reflect the IGA).²

The notice provides guidance to FFIs entering into agreements with the IRS pursuant to FATCA, including coordination of the new legislation with existing reporting and withholding rules. The notice also includes a much-anticipated draft FFI agreement, and notes the IRS will finalize it by the end of the year. Although the notice generally contains no surprises, it represents an important development as FATCA's start date of July 1, 2014, fast approaches.

Notice Highlights

The notice provides general background on the scope of the statutory and regulatory requirements for FFIs, as well as FFIs and branches of FFIs treated as reporting financial institutions under an applicable Model 2 IGA (Reporting Model 2 FFIs). Generally, any FFI or Reporting Model 2 FFI that can comply with the required terms of an FFI agreement is eligible to enter into such FFI agreement. A Reporting Model 2 FFI also must register with the IRS to obtain a global intermediary identification number (GIIN).

1 The Treasury has signed nine IGAs and reached 16 agreements in substance, with many others under negotiation.

2 So far, only Japan and Switzerland have entered into Model 2 IGAs.

The IRS is working on modifying the agreements for a qualified intermediary (QI), withholding foreign partnership (WP) and a withholding foreign trust (WT), so as to add new requirements under Chapter 3 (the existing withholding regime) and Chapter 4 (the FATCA regime) of the Internal Revenue Code.

The notice also provides a description of some of the intended updates to the regulations under FATCA and other withholding/reporting regimes of the code. Specifically, the notice indicates that Treasury and the IRS intend to issue regulations that would:

- Permit participating FFIs to satisfy existing (non-FATCA) reporting obligations if they report pursuant to their FFI agreements, though participating FFIs will still be required to issue Forms 1099s to the extent backup withholding applies to a payment.
- Permit payors to withhold only under one regime. That is, backup withholding will not apply if FATCA withholding applies, but a participating FFI will be permitted to elect to withhold at the backup withholding rates rather than the FATCA rates.
- Modify the transitional FATCA reporting requirements for calendar years 2015 and 2016 with respect to payments of foreign reportable amounts made to nonparticipating FFIs. Under the current regulations, a participating FFI is required to report the aggregate amount of these amounts paid to each payee that is a nonparticipating FFI, even where such payments are not associated with a financial account. The new rule will only require reporting where amounts are paid with respect to a financial account that the participating FFI maintains for the nonparticipating FFI. In addition, a participating FFI will have the option of reporting all payments made to the account if it does not want to distinguish between the types of payments made.
- Create a new category of nonfinancial foreign entity (NFFE) that is not a passive NFFE — called a Direct Reporting NFFE. Direct Reporting NFFEs will be defined as NFFEs that elect to report information with respect to their shareholders directly to the IRS (on Form 8966) rather than providing that information to payors/withholding agents.
- Modify the rules so that an NFFE acting as a QI, WP or WT will not be treated as a passive NFFE. This modification will be consistent with the revised QI, WP and WT agreements that will make clear that such NFFEs must report directly to the IRS about payments made.
- Modify the definition of U.S. person to include a foreign insurance company that is not a specified insurance company and that elects to be subject to U.S. income tax as if it were a U.S. insurance company.

The notice also details the procedures for registering for: (i) participating FFI status, (ii) Reporting Model 2 FFI status and (iii) sponsoring entities (*i.e.*, entities that agree to perform the due diligence, withholding and reporting of one or more FFIs pursuant to the FATCA regulations).

Finally, the notice provides a draft FFI agreement that substantially incorporates the provisions set forth in the FATCA regulations (Treas. Reg. § 1.1471-4) and includes appropriate modifications for Reporting Model 2 FFIs.