

# IRS and Treasury Department Publish Anticipated FATCA Guidance

February 9, 2012

*Proposed Regulations under the Foreign Account Tax Compliance Act Issued February 8, 2012*

On February 8, 2012, the U.S. Treasury Department and the Internal Revenue Service ("IRS") released widely anticipated proposed regulations (the "Proposed Regulations")<sup>[1]</sup> implementing the information reporting and withholding tax provisions commonly referred to as the Foreign Account Tax Compliance Act ("FATCA").<sup>[2]</sup> Enacted in 2010 as part of the Hiring Incentives to Restore Employment Act, the intent of FATCA is to prevent U.S. tax evasion by U.S. taxpayers using foreign accounts by imposing a withholding tax obligation unless those accounts are disclosed. In certain cases, withheld amounts are not creditable against U.S. tax liability.

Below is a brief summary of the major topics of the Proposed Regulations, including highlights of how the Proposed Regulations change prior IRS guidance. The Proskauer Tax Group's comprehensive analysis of the Proposed Regulations and their anticipated impact will follow in more detailed client alerts.

FATCA generally requires every foreign financial institution ("FFI") – including many offshore investment funds, as well as conventional financial institutions such as banks – to enter into an "FFI Agreement" with the IRS and to comply with specific documentation and information reporting requirements with respect to its U.S. account holders. If an FFI is not in compliance with FATCA, that FFI generally will be subject to a 30 percent withholding tax on any "withholdable payments." Any "withholdable payment" made to certain non-U.S. entities that are not FFIs ("non-financial foreign entities" or "NFFEs") is also subject to withholding, unless such NFFE either certifies that it has no substantial U.S. owners or discloses such U.S. ownership. A "withholdable payment" is broadly defined to include any payment of income from sources within the United States (other than income effectively connected with a U.S. trade or business) received after December 31, 2013 or gross proceeds from the sale of property that can produce either interest or dividends from U.S. sources realized after December 31, 2014.

Since its enactment, FATCA has caused substantial concern among private investment fund managers and institutional investors in the asset class, as well as the broader financial services industry worldwide, that its requirements will be overly burdensome and that its reach will extend beyond its intended scope. Most, if not all, non-U.S. private investment funds will be FFIs. Further, U.S. private investment funds are likely to include FFIs and NFFEs among their investors, which will trigger the new FATCA compliance and withholding requirements.

The Proposed Regulations represent comprehensive guidance on the step-by-step process for U.S. account identification, information reporting and withholding requirements for FFIs, NFFEs and U.S. withholding agents. The Proposed Regulations modify in important ways the preliminary guidance contained in three prior IRS Notices (the "Notices").[\[3\]](#)

*Additional Categories of Deemed-Compliant FFIs.* The Proposed Regulations provide additional guidance regarding "deemed compliant" FFIs (generally, FFIs that will not be required to take further steps to comply with FATCA), including "qualified collective investment vehicles," retirement plans and non-profit organizations. In general, an FFI that is not "deemed-compliant" will be required to become a "participating FFI" (by entering into an FFI Agreement) to be in compliance with FATCA.

*Government-to-Government Framework.* The preamble to the Proposed Regulations (the "Preamble") announces that the Treasury Department and IRS are considering an alternative approach to FATCA implementation, whereby an FFI will provide the relevant compliance information to the government of its home country and that government, in turn, will provide that information to the IRS. Simultaneously with the issuance of the Proposed Regulations, the Treasury Department jointly issued a statement with the governments of France, Germany, Italy, Spain and the United Kingdom that expressed these countries' mutual intent to pursue this type of government-to-government framework for implementing FATCA.

*"Passthru" Payments.* Under the Proposed Regulations, withholding will not be required with respect to "foreign passthru payments" before January 1, 2017. Generally, "foreign passthru payments" are payments made by a participating FFI to any of its "recalcitrant account holders" (very generally, account holders who do not provide the required information to the FFI), including non-participating FFIs. This substantially delays the implementation of withholding on foreign passthru payments in response to comments received on the Notices. The Preamble includes a request for further comments regarding the implementation of withholding on foreign passthru payments.

*Expanded Scope of Grandfathered Obligations.* The Proposed Regulations provide that any "obligation" outstanding on January 1, 2013 is a "grandfathered obligation," payments in respect of which are excluded from FATCA withholding. Generally, an obligation includes any legal agreement that produces or could produce a withholdable payment or passthru payment, other than an instrument that is treated as equity for U.S. tax purposes or that lacks a stated expiration or term. The Treasury Department and the IRS have requested comments on whether the definition of "obligation" for this purpose should be expanded to include interests in certain investment vehicles.

*Due Diligence Requirements.* The Proposed Regulations outline in detail the due diligence an FFI will be required to complete in order to satisfy its obligations under FATCA to identify its U.S. accounts, including differing guidelines for individual and entity accounts as well as for pre-existing and new accounts. These guidelines significantly modify the due diligence procedures outlined in the Notices. The Proposed Regulations also provide guidance on the types of information FFIs and those persons dealing with FFIs may rely upon in applying the FATCA rules.

*FFI Agreement.* The Proposed Regulations include a general description of the provisions of the FFI Agreement, and the Preamble announces that a draft model FFI Agreement is expected in early 2012.

*Transitional Rules for Compliance for Certain Affiliates.* In the Notices, the IRS stated that each FFI that is a member of an expanded affiliated group must be a participating FFI or deemed-compliant FFI in order for *any* FFI in the expanded affiliated group to become a participating FFI.<sup>[4]</sup> Under the Proposed Regulations, prior to January 1, 2016 an FFI affiliate in a jurisdiction that prohibits the type of reporting or withholding required by FATCA will not prevent the other FFIs within the same expanded affiliated group from entering into an FFI Agreement, as long as the FFI in the restrictive jurisdiction agrees to perform due diligence to identify its U.S. accounts, maintain certain records and meet certain other requirements.

*Revised IRS Forms W-8 and W-9.* The Preamble states that IRS Forms W-8 and W-9 will be updated to permit a payee to establish its status for FATCA purposes on such forms.

*Effective Date.* Although the Proposed Regulations are effective only when finalized, it would be prudent for organizations to assess their FATCA obligations under the Proposed Regulations and plan accordingly as the Proposed Regulations impose a variety of implementation deadlines.

If you would like to discuss the Proposed Regulations or FATCA-related matters generally at any time, please contact any of the lawyers listed on this alert or the member of the Proskauer Tax Group with whom you normally consult on these matters.

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[1] REG-121647-10.

[2] FATCA refers to sections 1471 through 1474 of the Internal Revenue Code of 1986, as amended.

[3] IRS Notice 2011-53, 2011-32 I.R.B. 124 (Aug. 8, 2011); IRS Notice 2011-34, 2011-19 I.R.B. 765 (May 9, 2011); IRS Notice 2010-60, 2010-37 I.R.B. 329 (Aug. 27, 2010). Please see our previous client alert, "[IRS Issues Preliminary Guidance on the Application of the Foreign Account Tax Compliance Act](#)" (Sept. 24, 2010).

[4] Notice 2011-34, 2011-19 I.R.B. 765 (May 9, 2011).

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