

Global Financial Services

New IRS FATCA Guidance Addresses Some Key Questions and Simplifies Certain Procedures, but Significant Operational Challenges Remain

On April 8, 2011, the U.S. Internal Revenue Service (“IRS”) issued Notice 2011-34 (“the Notice”) on withholding, documentation, and reporting requirements under the FATCA sections of the HIRE Act of 2010, which are intended to combat under-reporting by U.S. individuals of income earned outside the U.S.

In the Notice, the U.S. Treasury and the IRS have responded to comments made by practitioners by simplifying some of the compliance burdens for foreign financial institutions (“FFIs”). Nonetheless, as the Notice implements laws that were intended as a severe response to perceived abuse, compliance will entail significant operational challenges. In particular, the Notice introduces added complexity in the case of the private banking industry and imposes significant additional responsibilities upon private banking relationship managers.

Further, the procedures required under the Notice are geared to the banking industry, so that its application to other entities, such as funds and insurers, remains unclear and will require further consideration. For example, the Notice does not include detailed guidance on what may or may not constitute a FFI.

The IRS has invited comments on the application of various provisions of FATCA to a range of financial institutions. The Notice therefore offers practitioners an opportunity to inform the IRS about their concerns. Comments on the Notice must be received by the IRS by June 7, 2011.

The full text of the Notice can be found at <http://www.irs.gov/pub/irs-drop/n-11-34.pdf>.

Highlights of the Notice include:

1. Updated Guidance on the Identification of Pre-existing Accounts.

The Notice sets forth a detailed step by step process for identifying account holders. The procedures provided in IRS Notice 2010-60 to identify pre-existing accounts of U.S. persons have been modified.

While certain procedures have been simplified, more onerous requirements have been introduced in the case of private banking divisions. In particular, bank relationship managers must review all accounts that have a balance or value of over \$50,000 on a specified date that have not been previously documented as U.S. accounts for evidence of U.S. account holders.

In performing this review, the managers must use their actual knowledge concerning the U.S. status of account holders and are also not entitled to rely on documentation that they know or have reason to know is unreliable or incorrect. Heightened review is also required in the case of accounts with a balance or value of \$500,000 or more on a specified date. FFIs are generally required to collect documentation with respect to certain U.S. and Non-U.S. accounts, and to obtain from U.S. account holders waivers on reporting client information to the IRS. The Notice also includes guidance on annual retesting procedures.

2. Initial Guidance on Passthru Payments.

FATCA requires participating FFIs to withhold 30% of any “passthru payment” made to a recalcitrant account holder or non-participating FFI.

- **Determination:** A payment to a recalcitrant account holder or non-participating FFI is treated as a passthru payment to the extent of (a) the amount of the payment that is a “withholdable payment,” plus, (b) the amount that is not a withholdable payment multiplied the “passthru payment percentage.”
- **Calculation:** The FFI’s passthru payment percentage will generally be determined by dividing the sum of FFI’s “U.S. assets” on each of the last four quarterly testing dates by the sum of the FFI’s total assets on those dates. In the case of a custodial payment, however, the calculation is performed with respect to the U.S. assets and total assets of the entity that issued the applicable interest or instrument. A participating FFI is required, within three months after its quarterly testing date, to make available its passthru payment percentage information calculated for that testing date, for example, on a website or database readily searchable by the public.
 - **Determination of Assets:** Based on quarterly or most recent financial statements, all on and off-balance sheet items as specified in future guidance should be included while assets held as custodian, agent or nominee for benefit of an account holder should be excluded.
 - U.S. assets include any investment of debt or equity in a domestic corporation and any other asset that could give rise to a passthru payment.
- As FFIs do not currently perform this calculation or maintain records of U.S. assets for these purposes, identifying “U.S. assets” and performing, transmitting, and publishing this calculation may entail significant operational challenges.

3. Requirements for “Deemed-Compliant” Status.

A deemed-compliant FFI must apply for status with the IRS, obtain a FFI EIN, and certify every three years that it meets the requirement for such treatment.

Certain local banks, local FFI members of participating FFI groups, and certain investment vehicles are eligible to apply for deemed-compliant status. While deemed compliant entities will be able to avoid some of the significant account-identification and information reporting duties under FATCA, the application and re-certification process may nonetheless entail significant burdens, as the FFI must establish to the satisfaction of the IRS its eligibility for deemed-compliant status. The IRS has indicated that certain additional entities, such as certain exchange-traded funds and foreign retirement plans will also be eligible to be deemed compliant and is currently considering the circumstances under which they will be deemed to be so eligible. The Notice requests comments regarding other categories of entities that should be treated as deemed compliant FFIs “because they possess certain characteristics, or have implemented appropriate policies and procedures, that are consistent with the purpose of the passthru payment rule.” It is strongly recommended that industry practitioners submit comments to the IRS as there is a window of opportunity to identify areas requiring clarification.

4. Further Guidance on the Reporting on U.S. Accounts by FFIs.

FFI account balance reporting will be limited to year-end balances or values, and in the case of investment fund accounts, as determined for the purpose that requires the most frequent determination of value. Furthermore, FFI must annually report on U.S. accounts (a) gross dividends paid or credited to the account, (b) gross interest paid or credited to the account, (c) other income paid or credited to the account, and (d) gross proceeds from the sale or redemption of property paid or credited to the account where the FFI acted as custodian, broker, nominee or agent for the account holder. Separate branch-level reporting can be elected to accommodate local restrictions on the transfer of account information. This approach simplifies the reporting requirements previously proposed under Notice 2010-60,

which indicates that the IRS has been responsive to practitioners' comments about the administrative complexity of FATCA.

5. Treatment of Qualified Intermediaries (QIs).

FFIs currently acting as QIs will be required to become participating FFIs, unless they qualify as deemed compliant FFIs, effective January 1, 2013. The same rules will apply to FFIs acting as Foreign Withholding Partnerships (FWP) or Foreign Withholding Trusts (FWT). The U.S. Treasury and the IRS will coordinate between the FATCA and QI, FWP, FWT regimes. These requirements confirm practitioners' general expectation of coordination of the FATCA and QI rules, given the reporting procedures already in place for QIs.

6. Application of FATCA to Expanded Affiliated Groups.

The Notice provides that U.S. Treasury and the IRS will issue regulations requiring that each FFI in an FFI Group be a participating FFI or deemed compliant FFI under a coordinated procedure. Specifically, FFI affiliates will apply for FFI or deemed compliant FFI status through a coordinated application process for which a 'lead FFI' will be designated for each group and will file an application on behalf of each group member, provide the IRS with

documentation evidencing that each affiliate has agreed to the FFI Agreement, and represent that it is authorized to act as agent in contracting with the IRS. That being said, each FFI affiliate will be obligated to conduct its own due diligence, withholding and reporting. The U.S. Treasury and the IRS intend to provide the option for one FFI to act as a "Compliance FFI", handling compliance with FATCA for all group members (e.g., establishing and enforcing policies and procedures).

The IRS has invited comments on this approach.

7. Certification requirement.

New procedures have been included for participating FFIs to certify their completion of the requirements for determining the status of their pre-existing individual accounts. In a bid to ensure there is personal responsibility to comply with the requirements, certifications must be made by the chief compliance officer or an equivalent-level officer of the FFI. The IRS will provide further guidance about the certification requirements. These requirements will reinforce the central role of the FFI compliance function in implementing the FATCA requirements. Further clarification of this aspect of the FATCA rules should therefore be monitored carefully.

For more information

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U.S. Treasury and the IRS intend to issue proposed regulations and related guidance incorporating the principles contained in the two Notices and addressing other matters necessary to implement FATCA. Future guidance is expected to include a draft FFI Agreement and draft information reporting and certification forms.

PwC will also host a webcast on Thursday April 14 from 3:00 pm – 4:30 pm GMT, to provide further analysis of the Notice. You can register for this webcast at <http://www.pwc.com/us/tax/events>

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