



New Proposed FATCA Regulations

February 9, 2012

On February 8, 2012, the Internal Revenue Service (“IRS”) and Treasury Department issued proposed regulations interpreting certain provisions of the Hiring Incentives to Restore Employment Act of 2010 (which was enacted on March 18, 2010) that are commonly referred to as “FATCA.” Also on February 8, 2012, the Treasury Department issued a joint statement with France, Germany, Italy, Spain and the United Kingdom expressing an intent to provide an intergovernmental cooperation regime which would be an alternative means to comply with FATCA. FATCA imposes a broad information reporting and withholding regime designed to combat tax evasion by US persons holding assets in non-US entities.

In the event information reporting is not complied with, FATCA applies three different withholding regimes -

- (1) Section 1471(a) of the Internal Revenue Code of 1986, as amended (the “Code”) provides for 30% withholding on certain US payments (“withholdable payments,” which include US-source dividends and interest and gross proceeds on the sale or disposition of property that would produce US-source income) made by US persons to foreign financial institutions (“FFIs,” which is broadly defined and includes not only foreign banks and insurance companies, but also non-US investment fund entities) who are not “FATCA Compliant.”
- (2) Section 1472 of the Code provides for 30% withholding on withholdable payments made by US persons to foreign entities that are not FFIs unless the foreign entity (i) certifies it has no substantial US owner (generally defined as a holder of a 10% equity interest) or (ii) discloses the name, address and TIN of each of its substantial US owners. Certain foreign entities (including public corporations and their affiliates) are exempt from these requirements.
- (3) Section 1471(b) of the Code generally requires FATCA Compliant FFIs to enter into an agreement with the IRS to withhold 30% on certain “passthru payments,” which include withholdable payments and a portion of certain non-US source payments made to non-compliant FFIs or to persons that do not comply with certain information reporting requirements and are not otherwise exempt persons (“recalcitrant account holders”).

Delayed Implementation of Withholding - Withholding pursuant to FATCA will not take effect until 2014 with respect to periodic income such as dividends and interest, and will not take effect until 2015 with respect to proceeds from the sale of US stocks and securities. As discussed below, the proposed regulations also delay withholding with respect to foreign passthru payments.

FATCA Compliant FFI. In order to be FATCA Compliant an FFI (other than a limited category of deemed compliant FFIs such as local banks) generally must enter into an agreement with the Treasury Department which will generally require the FFI (and generally, its affiliates) to -

- (1) obtain information necessary to determine its US owners and comply with verification and due diligence procedures;
- (2) provide the US with annual information reporting regarding its US owners, account balances and account earnings;
- (3) withhold 30% on the US portion of payments to recalcitrant account holders or non-compliant FFIs to which the FFI makes payments; and
- (4) obtain waiver of any applicable foreign secrecy law which would prevent disclosure of information from an account, or if waiver is not obtained within a reasonable time, close such account.

HIGHLIGHTS OF THE PROPOSED REGULATIONS AND PREAMBLE

Expansion of “Grandfathered Obligations”: The proposed regulations provide that withholding shall not apply to an obligation outstanding on January 1, 2013 (FATCA previously grandfathered any obligations outstanding on March 18, 2012). An obligation is generally considered outstanding on January 1, 2013 if it has an issue date prior to January 1, 2013.

Passthru Payments: In addition to 30% withholding on the passthru of a withholdable payment, prior IRS Notices required FATCA Compliant FFIs to withhold 30% of other payments made to a recalcitrant account holder (a “foreign passthru payment”) to the extent of the percentage of US assets of the FFI. While the proposed regulations continue to provide that a FATCA Compliant FFI withhold 30% with respect to withholdable payments, the regulations reserve on what should be considered a foreign passthru payment. The preamble to the proposed regulations (the “Preamble”) indicates that the IRS is considering including a de minimis exception and a safe harbor percentage to foreign passthru payments. Moreover, the proposed regulations delay withholding on foreign passthru payments until 2017 at the earliest.

Extension of the Transition Period for the Scope of Information Reporting: The proposed regulations provide that reporting on certain periodic income will be phased in beginning in 2016 and reporting on gross proceeds will begin in 2017 (in each case for the prior year).

Revised IRS Forms W-8 and W-9: Certification of a payee’s status under FATCA (including as an FFI, and certification of any substantial US ownership) will be established pursuant to revised IRS Forms W-8 and W-9. Such revised IRS Forms will be published in the future.

“Owner-Documented” FFIs: The proposed regulations provide for an alternative compliance regime for “Owner-Documented FFIs.” An Owner-Documented FFI will not itself withhold any payments or provide information reporting. However, the definition of Owner-Documented FFI includes strict requirements which make compliance with this exception difficult, including: (a) the FFI cannot maintain financial accounts with a non-compliant FFI; (b) non-FFI account holders must report all US ownership, not just substantial US ownership; (c) all withholding agents have to agree to comply with FATCA information reporting and withholding on behalf of the Owner-Documented FFI; and (d) the FFI cannot issue debt that constitutes a financial account in excess of \$50,000 to any person.

Coordination with Other Withholding Regimes: The proposed regulations contain the statutorily mandated coordination provision with respect to other withholding regimes, clarifying that any required withholding applicable to certain periodic income received by non-US persons is reduced to the extent there has been withholding under FATCA.

Exception of “Financial Account” for Certain Interests in Banks and Insurance Companies: The proposed regulations contain a key exception to the definition of “financial account” for most debt and equity securities issued by banks, insurance companies and brokers (however this exception does not apply to investment funds).

Compliance Certification Requirement: To be a FATCA Compliant FFI, the proposed regulations require an officer of the FFI to certify compliance with the relevant FFI agreement.

Possible Guidance on “FATCA Blockers”: The Preamble states that the IRS is exploring rules that address the use of US entities as “FATCA blockers” with respect to foreign passthru payments made to non-compliant FFIs.

Alternative Compliance: The Preamble mentions that the IRS is considering an alternative form of compliance whereby the FFI would report the required information to the relevant local jurisdiction, which would then report that same information to the US. Importantly, it appears that this option will likely be limited to those countries with which the US has an applicable income tax treaty (and/or information exchange or other agreement). As mentioned above, the Treasury Department issued a joint statement with France, Germany, Italy, Spain and the United Kingdom expressing an intent to implement such alternative compliance.

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We will continue to monitor developments regarding the proposed regulations, which remain subject to change. In the meantime, if you have questions or would like to discuss these rules, please contact Rob Holo (rholo@stblaw.com; 212-455-2514), Marcy Geller (mgeller@stblaw.com; 212-455-3543), Jonathan Goldstein (jgoldstein@stblaw.com; 212-455-2048) or your regular Simpson Thacher tax department contact.

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