

FINAL REGULATIONS UNDER FATCA

I. INTRODUCTION.

On January 17, 2013, the U.S. Treasury Department and the Internal Revenue Service (the “IRS”) issued final regulations on the implementation of the Foreign Account Tax Compliance Act (“FATCA”).¹ The final regulations generally follow the proposed regulations issued in February 2012, but contain numerous changes and refinements, many of which reflect the extensive comments provided by the financial industry.

The principal goal of FATCA is to prevent tax evasion by U.S. taxpayers. Unfortunately, the rules implementing this objective have a very broad reach. The FATCA provisions introduce a complex and expansive reporting and withholding regime that is intended to force non-U.S. financial intermediaries and U.S.-owned foreign entities to identify and report on U.S. account holders and investors. This new regime will operate as a parallel system to the existing U.S. withholding tax and information reporting system, including the qualified intermediary (“QI”) program.

This Client Alert Memorandum highlights key aspects of the final regulations and the emerging FATCA compliance landscape. Particularly noteworthy are the following points:

1. Compressed (and very ambitious) implementation period. The final regulations generally adhere to the implementation timeline set forth in the IRS’s most recent pronouncement² and in the intergovernmental agreements (“IGAs”) that are being negotiated with other countries regarding FATCA coordination, so that as of January 1, 2014, all new accounts and obligations will need to be issued in conformity with FATCA and withholding will begin for certain payments of U.S.-source income. Thus, while the regulations and the IGAs phase in the effective dates (as described in Section IV.1 below), foreign financial institutions (“FFIs”), including investment funds, as well as U.S. financial institutions (“USFIs”) have a very short time period to develop and put in place new account on-boarding processes, to identify and begin withholding on certain holders of preexisting

¹ The 544-page Treasury Decision (T.D. 9610) containing the final regulations is available at <https://www.federalregister.gov/articles/2013/01/28/2013-01025/regulations-relating-to-information-reporting-by-foreign-financial-institutions-and-withholding-on>.

² Announcement 2012-42.

accounts, and in the case of FFIs, to register with the IRS as participating FFIs (on an online portal that is scheduled to commence operation by July 15, 2013).

2. Further guidance to come. The final regulations do not include all of the guidance that will be necessary for USFIs and FFIs to implement FATCA. Additional guidance is expected to be issued in the coming months, including (i) a model FFI agreement and instructions; (ii) guidance coordinating the FATCA reporting and withholding requirements imposed pursuant to new chapter 4 of the Internal Revenue Code of 1986, as amended (the “Code”),³ with the similar requirements imposed under IGAs, the existing reporting and withholding rules relating to U.S.-source dividends, interest and other “FDAP” income imposed under chapter 3 and the information reporting rules of chapter 61; and (iii) revised Forms W-9, W-8BEN (for individuals to certify foreign status), W-8BEN-E (for entities to certify foreign status and type of chapter 4 entity), the other forms of the W-8 series (Forms W-8IMY, W-8EXP and W-8ECI), Forms 1042 and 1042-S and new Form 8966 (for FATCA reporting). The United States is continuing to negotiate IGAs with many countries, and those countries that enter into Model 1 IGAs (providing for FFIs and branches in those countries to report FATCA information to those governments, which will in turn provide the information to the IRS) will need to issue guidance regarding the identification and reporting of U.S. accounts in conformity with those IGAs. Similarly, the implementing guidance to be issued by Model 2 IGA countries may affect FFIs’ obligations under the final regulations to some extent. The delay in issuing at least some of this guidance may impede the efforts of financial institutions to implement the new rules in a timely manner.

3. Coordination with IGAs; overlap issues for FFIs and foreign branches of USFIs. The final regulations take important steps towards better conforming the regulations and the IGAs, but there will remain material differences in the applicable rules, which will complicate compliance by multinational groups whose various FFIs and branches are subject to different requirements under the regulations and applicable IGAs. Unfortunately, in the absence of further guidance, foreign branches of USFIs that are in IGA countries will be subject to both the IGA rules and the FATCA regulations applicable to USFIs, while those branches that are QIs will be subject to both the FATCA regulations applicable to USFIs and to those that are applicable to FFIs that are QIs.

4. Welcome simplification but extraordinary complexity remaining. Treasury and the IRS have adopted many significant and helpful approaches in implementing FATCA to ease the costs and administrative burdens of compliance. Nonetheless, they have declined to follow certain recommendations that would have made the rules more easily administrable, and the resulting regime is extraordinarily complicated. Large and small financial institutions around the world will need to devote substantial

³ Unless otherwise indicated, all chapter and section references are to the Code, or to the Treasury regulations promulgated thereunder.

resources and time to FATCA compliance, and in many cases will need to obtain U.S. tax-centric information from customers and counterparties who have little or no U.S. nexus.

Part II provides a general overview of the FATCA provisions. Part III then describes the IGAs. Finally, Part IV highlights the salient aspects of the FATCA regime under the final regulations.

II. OVERVIEW OF FATCA.

Under the FATCA regime, withholding agents, including FFIs, will be required to withhold a 30% U.S. tax with respect to any “withholdable payment” made to a foreign entity, unless the foreign entity complies with the FATCA reporting requirements or qualifies for an exemption from these provisions.⁴ Subject to significant transition rules, this withholding tax will apply to payments made after December 31, 2013. Withholdable payments include (i) U.S.-source dividends, interest or other “fixed or determinable annual or periodical gains, profits, and income” (also known as “FDAP” income); and (ii) any gross proceeds from the sale of assets that can produce U.S.-source dividends or interest. As discussed in greater detail below, these rules generally will not apply to “obligations” that are outstanding on January 1, 2014.

The FATCA rules impose detailed due diligence and reporting requirements for FFIs. An FFI generally will be subject to the 30% U.S. withholding tax on withholdable payments *unless* it becomes a “participating FFI” by entering into an agreement with the IRS pursuant to which it generally will be required to (i) identify and report to the IRS information with respect to certain U.S. persons that directly or indirectly hold financial accounts in the FFI including depository and custodial accounts at the FFI and equity and debt of the FFI (subject to certain important exceptions described herein), (ii) withhold on “passthru” payments⁵ made to “recalcitrant” account holders⁶ and account holders (and

⁴ In general, exempt beneficial owners include: (i) foreign governments (including political subdivisions and entities wholly owned and controlled by foreign governments); (ii) international organizations; (iii) foreign central banks of issue; (iv) governments of U.S. possessions; (v) certain retirement funds; (vi) investment entities that are wholly owned by exempt beneficial owners and (vii) entities that are exempt under an IGA. The final regulations clarify that government-related entities will not be entitled to exemption with respect to a payment that is derived from an obligation held in connection with a commercial financial activity of a type engaged in by a bank, custodial institution or insurance company. The final regulations also expand the scope of the exemption for retirement funds. In addition, exceptions from FFI and NFFE status are provided for certain nonprofit organizations.

⁵ “Passthru” payments include not only U.S.-source FDAP income and gross proceeds from the disposition of property producing U.S.-source interest or dividends, but also may include certain foreign-source payments that are “attributable to” such amounts. Withholding generally will not apply to such foreign-source passthru payments before 2017, and only after additional guidance is issued with respect to such payments. See footnote 16, below.

certain other counterparties) that are nonparticipating FFIs, and (iii) in some cases, close accounts with respect to which reporting is not permitted. Under the final regulations and except as provided in an IGA, FFIs generally include the following foreign entities:

- banks;
- broker-dealers and other entities conducting custodial businesses;
- entities that conduct one or more of the following activities on behalf of customers: (i) trading in money market instruments, securities, currencies commodities and certain derivative instruments; (ii) portfolio management; or (iii) otherwise investing, administering or managing funds, money or financial assets;⁷
- professionally managed investment funds (*i.e.*, entities whose gross income is primarily attributable to investing, reinvesting or trading in financial assets) or other entities that function or hold themselves out as collective investment vehicles that are established to invest, reinvest or trade in financial assets (*e.g.*, non-U.S. mutual fund-like vehicles such as UCITS and SICAVs, hedge funds, private equity funds, securitization vehicles and virtually any other private or widely held investment entity), and generally including an investment fund that uses a professional management entity for any of its assets;
- certain holding companies and treasury centers that are part of financial groups or that are “formed in connection with or are availed of” by investment vehicles; and
- certain foreign insurance companies.

A foreign entity that is not an FFI (which FATCA refers to as a non-financial foreign entity (“NFFE”)), and that is not otherwise exempt,⁸ will be able to avoid the 30%

⁶ A “recalcitrant” account holder generally is an account holder that fails to provide information required to determine whether the account is a U.S. account or other information required to be reported by the FFI, or that fails to provide a waiver of any foreign law that would prevent reporting with respect to the account holder.

⁷ For this purpose, a “financial asset” is a security, partnership interest, commodity, notional principal contract, insurance contract or annuity contract, or any interest (including a futures or forward contract or option) in a security, partnership interest, commodity, notional principal contract, insurance contract, or annuity contract.

⁸ The following “excepted” NFFEs generally are exempt from FATCA withholding: (i) corporations the stock of which is regularly traded on an established securities market and their affiliates; (ii) “active NFFEs” (*i.e.*, entities whose gross income or assets are predominantly non-passive); (iii) certain holding companies, treasury centers and captive finance companies that are members of nonfinancial

U.S. withholding tax on withholdable payments only if (i) it provides the name, address and taxpayer identification number of each of its “substantial United States owners;”⁹ (ii) the withholding agent does not know or have any reason to know that the information is incorrect; and (iii) the withholding agent reports that information to the IRS.

III. THE INTERGOVERNMENTAL AGREEMENTS.

When Treasury released the proposed regulations last year, it also issued a joint statement with France, Germany, Italy, Spain and the United Kingdom regarding the intention to develop an intergovernmental approach to FATCA implementation. The intergovernmental regime is intended to facilitate non-U.S. financial institutions’ compliance with FATCA in a manner that is consistent with local legal and regulatory constraints under which they operate. The United States and these five countries released the first model intergovernmental agreement (the “Model 1 IGA”) in July 2012. A second Model IGA (the “Model 2 IGA”), developed with Switzerland and Japan, was later released in November 2012.

Under the Model 1 IGA, partner-country financial institutions (“reporting Model 1 FFIs”) will report information about U.S. account holders to their own government instead of to the IRS, and the partner government in turn agrees to transfer the information on an automatic basis to the IRS. Financial institutions operating in a Model 1 jurisdiction will not be required to enter into an FFI agreement with the IRS, and generally will not be subject to the requirements of the regulations, but rather will be required to implement FATCA’s requirements through the local law requirements adopted to implement the relevant IGA. Under the Model 2 IGA, partner-country financial institutions will report information about U.S. account holders directly to the IRS, except with respect to “non-consenting accounts,” specific information with regards to which the IRS may seek through the partner government. A financial institution operating in a Model 2 jurisdiction will be required to enter into an FFI agreement, and thus generally will be subject to the regulations, although its obligations under that agreement will be modified as required by the relevant IGA. In addition to addressing local legal and regulatory constraints on FATCA compliance, the IGAs narrow the scope of financial institutions in the partner country that

groups; (iv) nonfinancial start-up companies; and (v) nonfinancial entities that are liquidating or emerging from reorganization or bankruptcy. Exempt beneficial owners described in footnote 4 also are exempt from the withholding tax imposed on NFFEs.

⁹ A “substantial United States owner” generally is any “specified United States person” that owns, directly or indirectly, more than 10% of the equity of the NFFE, although in the case of certain investment entities *any* specified United States person is treated as a substantial United States owner, regardless of the size of its ownership interest. A “specified United States person” generally is any U.S. person *other than* regularly traded corporations and their affiliates; banks; securities, commodities and derivatives dealers; brokers; governmental entities; RICs; REITs; retirement funds and certain tax-exempt organizations and trusts.

are subject to FATCA and relax certain other FATCA compliance requirements for those institutions.

Treasury has announced that it is engaged in discussions regarding these issues with more than fifty countries. To date, the United States has signed or initialed IGAs with seven countries: the United Kingdom, Mexico, Ireland, Denmark, Spain, Switzerland and Norway.

Given the parallel frameworks that are being implemented, a foreign financial institution (or branch) may be subject to one of three FATCA regimes: a Model 1 IGA, the final regulations as modified by the terms of a Model 2 IGA, or only the final regulations. Although in a number of respects the IRS attempted to coordinate the final regulations' requirements with those applicable to FFIs operating in IGA jurisdictions, the differing requirements applicable under these similar regimes will complicate FATCA compliance in some respects for financial groups, or individual financial institutions, operating in several different jurisdictions. For example, a financial institution that is not located in an IGA jurisdiction but has branches that operate in IGA jurisdictions may be required to implement different due diligence and reporting procedures for each jurisdiction in which it operates, and this complexity may be magnified in the context of a large expanded affiliated group with global operations. Moreover, the IGAs will be implemented through the local law of each partner jurisdiction, and therefore the exact details of the FATCA scheme will likely vary from country to country.¹⁰ Thus, while an IGA may simplify the ability of a local operation to comply with FATCA, the structure of the IGA regime may make it difficult for multinational institutions and groups to develop uniform compliance systems.

IV. HIGHLIGHTS OF THE FATCA REGIME UNDER THE FINAL REGULATIONS.

1. A Phased Implementation Timeline.

Grandfathered obligations. As noted above, the final regulations extend the statutory “grandfather” rule from March 18, 2012 so as to cover debt securities, loans and other “obligations” outstanding on January 1, 2014.¹¹ Thus, payments on obligations issued

¹⁰ So far, the U.K. is the only IGA partner that has issued draft regulations to implement FATCA. The draft regulations are available at <http://www.hmrc.gov.uk/drafts/uk-us-fatca-regulations.pdf>, and draft guidance is available at <http://www.hmrc.gov.uk/drafts/uk-us-fatca-guidance-notes.pdf>.

¹¹ For this purpose, the term “obligations” means legal agreements that produce or could produce withholdable payments or passthru payments, other than instruments that are treated as equity for U.S. tax purposes or that lack a stated expiration or term (such as a savings deposit or demand deposit). The grandfathering generally covers post-2013 drawdowns under a line of credit or revolving credit facility whose material terms are fixed, but does not cover post-2013 transactions pursuant to a master agreement (e.g., a derivatives transaction confirmation under an ISDA master agreement), nor does it

before that date, and any gross proceeds from the disposition of such obligations, generally will not be subject to FATCA. In addition, obligations issued in a “qualified reopening” of grandfathered obligations will themselves be grandfathered. Moreover, collateral posted as security for grandfathered obligations is also grandfathered.¹²

The *due diligence requirements* under an FFI agreement are phased in over time and based on the account’s size and characteristics and whether it is a “preexisting account.”¹³ In general:

- For preexisting *entity* accounts, a participating FFI generally must complete the required diligence within 6 months of the effective date of its FFI agreement (generally June 30, 2014) for any account holder that is a “prima facie FFI,”¹⁴ and within two years of the effective date of its FFI agreement (generally December 31, 2015) for other accounts (accounts with balances of \$250,000 or less may be exempt, however).
- For preexisting *individual* accounts, a participating FFI generally must complete the required diligence within one year of the effective date of its FFI agreement (generally December 31, 2014) for “high-value accounts” (*i.e.*, accounts having a balance or value that exceeds \$1 million), and within two years of the effective date of the FFI agreement (generally December 31, 2015) for other accounts.

cover an obligation once it has been significantly modified for purposes of section 1001.

¹² If collateral secures both grandfathered and non-grandfathered obligations, a pro rata (by value) share of the collateral will be grandfathered.

¹³ In general, a “preexisting” account is an account that is maintained on December 31, 2013 or, if later, the effective date of the FFI’s FFI agreement. A subsequently opened account (or other obligation) may also qualify as a preexisting account (or other obligation) if the withholding agent treats it as a “consolidated obligation” with a preexisting obligation (see Section IV.4 below) and is permitted to rely on due diligence performed for the preexisting obligation to satisfy its obligations under anti-money laundering (“AML”) rules (if any) for the subsequently opened account (or other obligation).

¹⁴ An entity is treated as a prima facie FFI if (i) the withholding agent’s electronically searchable information indicates that the payee is a QI or non-qualified intermediary for normal withholding tax purposes; or (ii) for an account maintained in the United States, the payee is presumed to be a foreign entity, or is documented as a foreign entity for purposes of the regular withholding tax or information reporting rules, and the withholding agent has recorded as part of its electronically searchable information a standardized industry code that indicates that the payee is a financial institution. The regulations provide a short list of North American Industry Classification System (“NAICS”) and Standard Industrial Classification (“SIC”) codes that indicate that the payee is a financial institution.

The *reporting requirements* also are phased in over a number of years:

- Reporting for calendar years 2013 and 2014: The information that participating FFIs must report with respect to 2013 and 2014 is limited to basic account holder identifying information and the account balance or value as of the end of the year. No payments made with respect to the account will be required to be reported. This information must be reported by March 31, 2015.
- Reporting for calendar year 2015: In addition to the information required to be reported with respect to 2013 and 2014, the aggregate gross amounts of interest, dividends and other income paid or credited to the account must be reported. No gross proceeds reporting will be required for 2015.
- Reporting for calendar year 2016 and later years: Full reporting will be required.

The *withholding requirements* are phased in over a number of years as well:

- Beginning on January 1, 2014, U.S.-source FDAP income will be subject to withholding if paid to new accounts (until appropriate documentation is provided) and to preexisting accounts of payees documented as nonparticipating FFIs.
- Preexisting accounts held by prima facie FFIs become subject to withholding on July 1, 2014 (until appropriate documentation is provided).
- Preexisting accounts held by persons other than prima facie FFIs generally will become subject to withholding on January 1, 2015 (in the case of non-compliant NFFEs) or January 1, 2016 (in the case of nonparticipating FFIs), in each case until appropriate documentation is provided.
- On January 1, 2017, withholding requirements generally will expand to include gross proceeds from the disposition of property producing U.S.-source interest or dividends, in addition to U.S.-source FDAP income (until appropriate documentation is provided).

2. *The Scope of Covered Payments Has Been Narrowed.*

- *Due diligence, reporting and withholding requirements have been deferred in respect of gross proceeds, certain derivatives,¹⁵ foreign passthru payments (i.e.,*

¹⁵ Specifically, dividend equivalent payments under swaps and similar transactions that are treated as U.S.-source withholdable payments under section 871(m) are grandfathered if the obligation is executed before 6 months after regulations applicable to such payments under section 871(m) become effective.

foreign-source payments that are “attributable” to U.S.-source withholdable payments)¹⁶ and collateral posted to secure these obligations (see Section IV.1 above). This deferral also addresses concerns raised under the proposed regulations’ treatment of brokerage “delivery vs. payment” (DVP) and similar transactions. Thus, subject to the following caveats, financial institutions will not immediately need to undertake the difficult task of developing customer identification, reporting and withholding processes for these areas. However, apparently the general effective dates under the regulations will apply to withholdable payments that are embedded in gross proceeds, such as the portion of a stock redemption payment that is treated as a dividend under section 302 or the imputed interest component of an installment sale payment. Moreover, because it is typical to post collateral on a pooled basis for all swaps, derivatives and other financial transactions entered into pursuant to a single ISDA master agreement, as a practical matter financial institutions will need to timely set up due diligence, reporting and withholding systems in respect of their derivatives businesses to cover interest on the portion of any collateral that secures non-grandfathered obligations.¹⁷

- ***Payments on short-term debt obligations*** (those having an original term to maturity of 183 days or less), including U.S. Treasury bills, are excluded from “withholdable payments.” Thus, payments on such obligations generally will not be subject to FATCA’s reporting and withholding requirements.¹⁸
- ***Nonfinancial payments*** (such as wages, leases, licenses and interest on accounts payable for goods and services) are excluded from the scope of FATCA.

¹⁶ The IRS released a proposal to implement the foreign passthru payment rule in Notice 2011-34. One very controversial aspect of that proposal was the requirement that an FFI withhold on the “passthru payment percentage” of each payment to a nonparticipating FFI or recalcitrant account holder (other than on U.S.-source FDAP income and gross proceeds, which are generally subject to FATCA withholding as withholdable payments). The final regulations defer the withholding on such foreign passthru payments until the later of January 1, 2017 or the date on which final regulations defining “foreign passthru payment” are published, and also provide that obligations that are executed on or before the date that is 6 months after such final regulations are filed with the Federal Register will be grandfathered. The regulations, however, require participating FFIs to report annually the aggregate amount of certain foreign-source payments (generally, foreign-source FDAP income) to nonparticipating FFIs, beginning for calendar year 2015.

¹⁷ See footnote 12 above.

¹⁸ The definition of “financial account” does not include a comparable exception. Thus, short-term obligations issued by an FFI that is an investment entity may be treated as accounts that are subject to FATCA’s due diligence, reporting and withholding obligations. (Debt obligations issued by other types of FFI generally are not treated as financial accounts, except in unusual circumstances.)

3. *The Categories of Entities Subject to FATCA Have Been Refined, But Issues Persist.*

The financial industry had hoped that many types of active financial institutions and investment entities would be excluded altogether or relieved from many of the compliance burdens of FATCA because they present a low risk of tax evasion. While the IRS has helpfully clarified and expanded several exceptions (including for group holding, treasury and finance companies, retirement plans and non-profit institutions, as well as for NFFEs that are engaged in an active business), the exceptions that are provided for active financial institutions and investment entities are not as broad as commentators had requested. Accordingly, a large number of entities will likely be fully subject to the FATCA rules, which will impose substantial compliance costs and burdens on them.

- ***Investment Entities.*** The final regulations follow the IGA approach with respect to an investment entity that does not function or hold itself out as an investment fund but invests or trades in financial assets, by requiring it to be managed by a professional trading or fund or portfolio management entity (or a bank, custodian or insurance company) in order to be an investment entity FFI. This limitation is intended to treat non-professionally managed investment vehicles (such as family offices and trusts) as passive NFFEs rather than FFIs. However, the regulations appear to treat an investment entity as professionally managed if *any* of its assets are under external professional management by an entity, so it is likely that this limitation will be unavailable to most family offices and trusts (unless they and all their investments are managed entirely by individual employees, trustees and/or other advisers).¹⁹
- ***Holding Companies, Treasury Centers and Captive Finance Companies in Nonfinancial Groups.*** The final regulations helpfully exclude from the definition of FFI a holding company, treasury center or captive finance company in a nonfinancial group.²⁰ However, this exclusion is not available to any such

¹⁹ It is unclear whether the IGAs will be interpreted as narrowly as the regulations.

The final regulations also adopt the IGA approach of including within the scope of an investment entity FFI an entity that primarily conducts as a business portfolio or fund management or trading in financial instruments on behalf of a customer. Thus, these investment management companies will need to register as FFIs even if they do not have any financial accounts (since debt and equity interests in such an entity generally are not financial accounts that are subject to FATCA).

²⁰ In general, a “nonfinancial group” is an expanded affiliated group that satisfies the following conditions: (i) no more than 25% of the group’s gross income (excluding the gross income of nonfinancial entities that are start-ups or are in liquidation or bankruptcy) may consist of passive income (as defined for NFFEs), (ii) at most 5% of the group’s gross income is derived by members that are FFIs (generally excluding certain intra-group transactions), (iii) no more than 25% of the fair market value of the group’s assets produce or are held for the production of passive income

company that was “formed in connection with or availed of by” a private equity fund, hedge fund or similar investment vehicle. The scope of this carveout is not clear, and thus for example holding companies that were once controlled by private equity funds (and FFIs that are their counterparties) may struggle with determining whether such companies are FFIs or NFFEs.

- ***Certain Holding Companies and Treasury Centers of FFI Groups.*** A non-publicly traded debt or equity interest²¹ in a holding company or treasury center that is a member of an expanded affiliated group that includes a bank, custodial institution, insurance company or certain investment entities or that was formed in connection with or availed of by an investment vehicle will be treated as a financial account that is subject to FATCA only in limited circumstances.²²

(excluding the assets of nonfinancial entities that are start-ups or are in liquidation or bankruptcy), and (iv) any member of the group that is an FFI is either a participating FFI or a deemed-compliant FFI.

An “expanded affiliated group” generally is an affiliated group in which each subsidiary is linked to a common parent through 50%-or-greater equity holdings, measured by both vote and value. In the case of a partnership or other non-corporate entity, the 50% ownership test is measured solely by value. There is an anti-abuse rule to prevent manipulation of the test. The final regulations exclude from membership in an expanded affiliated group certain investment entities that are formed with seed capital from a group member with the intention to sell the interests to unrelated investors.

²¹ The statute exempts from FATCA a financial institution’s debt and equity securities that are regularly traded on an established securities market. An established securities market includes, *inter alia*, an officially recognized foreign securities exchange with an annual trading volume of over \$1 billion for each of the preceding 3 years (as reported by the World Federation of Exchanges). A class of interests is regularly traded if there is trading (other than in de minimis quantities) on at least 60 days during the prior calendar year and the aggregate number of interests traded in that year is at least 10% of the volume outstanding.

²² Such a non-traded interest is treated as a financial account only if (i) the issuer’s expanded affiliated group includes one or more investment entities (other than an entity that primarily conducts as a business portfolio or fund management or trading in financial instruments on behalf of a customer) or passive NFFEs and the income derived by such investment entities or passive NFFEs is 50 percent or more of the aggregate income earned by the expanded affiliated group; (ii) the redemption or retirement amount or return earned on the interest is determined, directly or indirectly, primarily by reference to one or more entities described in clause (i); (iii) the value of the interest is determined, directly or indirectly, primarily by reference to assets that give rise (or could give rise) to withholdable payments; or (iv) the interest is issued with a principal purpose of avoiding the reporting or withholding requirements of chapter 4. For this purpose, the value of an equity interest will be treated as determined, directly or indirectly, primarily by reference to assets that give rise (or could give rise) to withholdable payments if (i) the amount payable upon redemption is secured primarily by reference to assets that give rise (or could give rise) to withholdable payments; or (ii) in the case of an unsecured interest, the amount payable upon redemption is determined primarily by reference to assets that give rise (or could give rise) to withholdable payments. The value of a debt interest is treated as determined, directly or indirectly, primarily by reference to assets that give rise (or could give rise) to withholdable payments if (i) the debt is convertible into stock of a U.S. person; (ii) amounts payable as interest or upon redemption or retirement of the debt are determined primarily by

Thus, in general, medium-term notes and other debt issued by a bank holding company or a special purpose subsidiary of a bank generally will not be a financial account. On the other hand, a literal reading of these rules would treat as a financial account the not uncommon situation of debt issued by such a holding company where its U.S. subsidiary pledges its assets to secure a guaranty of the holding company's debt.²³

- **Securitization Vehicles.** The final regulations contain a transition rule that is intended to treat a "limited life debt investment entity" ("LLDIE") as a certified deemed-compliant FFI²⁴ through 2016. Informal comments from IRS officials have indicated that thereafter, relief would be provided through the Cayman Islands IGA and other IGAs. However, unless several of the conditions for LLDIE status are modified or clarified,²⁵ this stop-gap exception will be unavailable to most securitization vehicles.
- **Deemed-Compliant Active Financial Institutions.** The final regulations contain exceptions (most of which were in the proposed regulations) granting deemed-compliant status to certain narrowly defined categories of active financial institutions. Deemed-compliant FFIs generally are treated as having satisfied their obligations under FATCA and thus are exempt from withholding to the same extent as participating FFIs. The IRS has indicated that relief for jurisdiction-specific arrangements meriting deemed-compliant treatment will be separately addressed in IGAs. While this may provide some countries an additional incentive to conclude an IGA, it provides no relief for the FFIs caught by the general rules.
 - An FFI member of a participating FFI group may qualify as a "nonreporting member" if it identifies all of its preexisting nonparticipating FFI and U.S. accounts and moves them to an affiliate that is a USFI, a participating FFI or

reference to profits or assets of a U.S. person; or (iii) the debt is secured by assets of a U.S. person.

²³ The final regulations also exclude an "excepted inter-affiliate FFI," which requires, *inter alia*, that the entity be a member of a participating FFI group, not maintain financial accounts (other than for members of its expanded affiliated group) and not hold an account with or receive payments from a withholding agent other than a member of its expanded affiliated group.

²⁴ As described below, a certified deemed-compliant FFI is not required to register with the IRS and may establish its status simply by providing documentation to a withholding agent.

²⁵ For example, the conditions include (i) the entity must be formed pursuant to a trust indenture (or similar fiduciary arrangement), and not merely issue interests pursuant thereto; (ii) the entity must be required to liquidate on or prior to a specific date, rather than merely when its portfolio is fully repaid or drops below a specified threshold; and (iii) the entity's organizational documents do not permit any amendments (not simply the amendments that would allow it to comply with FATCA) without the agreement of all its investors.

a reporting Model 1 FFI, or closes the accounts, within 6 months, and sets up policies and procedures to transfer any such future accounts to a participating FFI affiliate. The final regulations liberalize this rule somewhat by providing the FFI 6 months to transfer or close accounts (compared to 90 days as provided in the proposed regulations).

- A “local FFI” must meet certain restrictive conditions designed to ensure that it does not have U.S. account holders. Among other things, it (and each member of its expanded affiliated group) (i) cannot have an office outside of its country of organization, unless it is not publicly advertised and performs only back office functions; (ii) cannot solicit customers outside its home country, subject to narrow exceptions permitting limited use of websites and broadcast media; (iii) must have at least 98% of its accounts held by residents of its home country, or of the EU if its country is a member state of the EU; (iv) must implement policies to ensure that it does not open or maintain accounts for any specified U.S. person who is not a local resident, any nonparticipating FFI or any entity controlled or beneficially owned by a specified U.S. person; and (v) must be organized in an FATF-compliant jurisdiction²⁶ that regulates the entity as a financial institution and requires it to identify resident accounts for tax or AML purposes.
- “Nonregistering local bank” status provides an alternative to local FFI status for small FFIs. The entity must be licensed and regulated as a bank, credit union, or nonprofit credit cooperative, and engage primarily in the business of making loans and taking deposits from unrelated retail customers. It and each member of its expanded affiliated group cannot have an office or solicit customers outside its home country (other than as permitted for local FFIs). It cannot have more than \$175 million in assets, and its expanded affiliated group cannot have more than \$500 million in assets.
- FFIs with only “low-value accounts” must have no financial account with a balance or value in excess of \$50,000 and it and its expanded affiliated group must have no more than \$50 million in assets. An investment entity cannot qualify for this deemed-compliant status.
- A “qualified credit card issuer” is an entity that is an FFI solely because it is an issuer of credit cards that accepts deposits only when a customer overpays its balance. Qualified credit card issuers generally must implement policies and procedures to prevent customer deposits in excess of \$50,000 or ensure that any such deposit is refunded to the customer within 60 days.

²⁶ An FATF-compliant jurisdiction is a jurisdiction that does not have specified deficiencies in its compliance with AML and anti-terrorism financing rules of the Financial Action Task Force (“FATF”).

Nonreporting members of FFI groups, local FFIs and qualified credit card issuers are “registered deemed-compliant FFIs.” These entities are not required to enter into FFI agreements, but are required to register with the IRS and comply with certain procedural requirements (including periodic certifications from a responsible officer regarding their continued qualification for deemed-compliant status). Nonregistering local banks and FFIs with only low value accounts are “certified deemed-compliant FFIs,” which are not required to register with the IRS and may establish their status simply by providing documentation to withholding agents.

- ***Deemed-Compliant Investment Entities.*** The categories of special compliance status for investment entities have been refined and expanded somewhat, although they remain fairly narrow in scope:
 - Family trusts and certain other closely held investment entities may find some relief from their obligations under FATCA if they qualify as “owner-documented FFIs.” Under this rule, an investment entity FFI that meets the requirements described below will be entitled to be treated as a deemed-compliant FFI with respect to the payments that it receives from a withholding agent by entering into an agreement with the withholding agent. The FFI must not be owned by or be in an expanded affiliated group with any FFI that is a depository institution, custodial institution, or insurance company and must not maintain any financial account for a nonparticipating FFI. The FFI must provide to the withholding agent sufficient information to allow the withholding agent to comply with FATCA’s reporting requirements relating to the FFI, including detailed information and documentation regarding (i) every individual and specified U.S. person that owns a direct or indirect equity interest in the FFI and (ii) subject to certain exceptions, individuals and specified U.S. persons that own direct or indirect debt interests in the FFI to the extent that such debt interests constitute financial accounts in excess of \$50,000. Alternatively, the FFI may provide a recent letter from a U.S.-licensed auditor or attorney certifying that the FFI otherwise qualifies for this exception, along with documentation of each direct or indirect owner that is a specified U.S. person. The withholding agent also must agree to comply with reporting requirements with respect to any specified U.S. persons that are identified by the FFI, subject to exceptions for indirect owners that hold their interests through participating FFIs, deemed-compliant FFIs (other than owner-documented FFIs), U.S. persons, exempt beneficial owners, or excepted NFFEs (as defined below).

The requirement that holders of debt interests in excess of \$50,000 be reported to the withholding agent represents a significant liberalization from the comparable provision under the proposed regulations, which generally

prohibited the issuance of debt to any person in excess of \$50,000. This change may increase the utility of the owner-documented FFI rules for a number of small FFIs.

- The rules for “qualified collective investment vehicles” (“QCIVs”) are intended to provide relief from FATCA’s burdens for investment entities owned solely through participating FFIs and directly by large institutional investors that otherwise would not be subject to reporting or withholding under FATCA. QCIVs are investment entities that are regulated as investment funds²⁷ and that limit the direct holders of their debt and equity interests (other than debt interests of \$50,000 or less) to participating FFIs, registered deemed-compliant FFIs, nonreporting FFIs in IGA jurisdictions, U.S. persons that are not specified U.S. persons, non-profit organizations, and exempt beneficial owners.
- The deemed-compliant status for “restricted funds” is intended to provide relief for foreign investment entities that only target foreign investors. Thus, a restricted fund is an investment entity that is regulated as an investment fund²⁸ and imposes certain restrictions on the distribution of its interests to ensure that they are not sold to U.S. persons. These restrictions include, *inter alia*, that (i) distribution agreements must prohibit sales to specified U.S. persons, nonparticipating FFIs, and passive NFFEs with substantial U.S. owners (other than interests distributed by and held through participating FFIs); (ii) interests that are not issued directly by the fund may be sold only through distributors that are participating FFIs, certain deemed compliant FFIs or “restricted distributors,”²⁹ and (iii) with respect to interests issued directly by the fund, investors may only dispose of the interests by selling them back to the fund and not on the secondary market.

²⁷ The final regulations do not provide substantial guidance regarding the nature or the extent of the required regulation, other than requiring that the entity be regulated as an investment fund either in its country of incorporation or organization, or in all of the countries in which it is registered and in all of the countries in which it operates. Alternatively, the final regulations provide that the entity will qualify if its fund manager is regulated with respect to the fund in all of the countries in which the fund is registered and in all of the countries in which the fund operates.

²⁸ This requirement is comparable to the regulation requirement applicable to QCIVs described in footnote 27, above, although the final regulations limit a restricted fund’s country of incorporation or organization to FATF-compliant jurisdictions (as of the time the FFI registers for deemed-compliant status).

²⁹ A “restricted distributor” generally is a small, local distributor that, *inter alia*, is subject to AML due diligence procedures under the laws of an FATF-compliant jurisdiction, provides investment services to unrelated persons and holds interests in the fund as a nominee.

- The final regulations treat as deemed-compliant FFIs certain “sponsored investment entities,” “sponsored controlled foreign corporations” and “sponsored closely held investment vehicles,” where a sponsoring entity assumes the compliance burdens for these entities (see Section IV.7 below).

QCIVs, restricted funds, sponsored investment entities and sponsored controlled foreign corporations are registered deemed-compliant FFIs while owner-documented FFIs and sponsored closely held investment vehicles are certified deemed-compliant FFIs.

Investment entities that do not meet one of the foregoing exceptions will be subject to FATCA, and will need to become participating FFIs in order to avoid adverse consequences.

- **Active and Passive NFFEs.** The regulations helpfully expand the scope of NFFEs that are excluded from the owner documentation requirements (“excepted NFFEs”) to include “active NFFEs”³⁰ as well as holding companies, treasury centers and captive finance companies in nonfinancial groups,³¹ and also expand the documentary evidence upon which an FFI can rely in establishing the exempt status of an NFFE. Passive NFFEs (*i.e.*, NFFEs that are not excepted NFFEs) must identify and provide documentation regarding their substantial U.S. owners. Unfortunately, the regulations do not depart from the Code’s requirement that in the case of an investment entity a substantial U.S. owner is any specified U.S. person and in the case of any other NFFE it is any specified U.S. person that owns more than 10 percent of its equity. By contrast, the IGAs require that the NFFE report only specified U.S. persons that are “controlling persons” within the meaning of the FATF Recommendations, which in general is a 25 percent ownership threshold.

4. Account Due Diligence Requirements of FFIs and Other U.S. Withholding Agents.

The regulations prescribe detailed due diligence procedures that FFIs and other U.S. withholding agents are required to undertake and provide presumption rules that must be applied when the FFI or U.S. withholding agent does not obtain required documentation. In some respects, the final regulations simplify and better coordinate these procedures with existing procedures used by U.S. and foreign financial institutions. Nevertheless,

³⁰ In general, an entity is an active NFFE if less than 50 percent of its income for the preceding calendar year is passive income (excluding certain passive income from related persons and certain passive income from dealer activities) and less than 50 percent of the weighted average percentage (tested quarterly) of its assets are held for the production of passive income. IGAs employ a similar “active NFFE” concept but, as in other cases, differ from the regulations in that they do not specify precise formulas for applying the rule.

³¹ See generally footnote 8 and text accompanying footnote 20 above.

the required procedures remain quite complicated and will pose significant implementation challenges.

- ***General Rules Regarding Determination of Account Holder or Payee's Status.***
 - ***Documentation Rules.*** The requirements relating to the scope and validity of documentation have been simplified in the final regulations in a number of respects as compared to the proposed regulations, including permitting the use of self-certification in some contexts; permitting the use of existing documents such as pre-FATCA Forms W-8 (although in some cases, only on a transitional basis); increasing the types of documentary evidence that are acceptable; providing indefinite validity periods for certain types of documentation, in particular with respect to offshore obligations; removing the requirement that written statements provided in respect of offshore obligations that do not give rise to U.S.-source FDAP income be made under penalty of perjury; easing record retention requirements for offshore obligations; reducing restrictions on the electronic submission of documentary evidence; limiting the cases of changed circumstances that require a withholding agent to re-document an account; and permitting inconsequential errors on withholding certificates to be cured.
 - ***Sharing of Documentation.*** Although financial institutions generally are required to obtain documentation on an account-by-account basis, documentation may be shared within a branch, among different branches of a single financial institution or among separate financial institutions within an expanded affiliated group, provided the relevant branches or entities have a shared (or universal) account system that meets certain specified requirements relating to document access and the financial institution treats the shared accounts as a “consolidated obligation” (see below). However, technological and privacy-related impediments may limit a financial institution’s ability to share this documentation. A withholding agent may also rely on documentation collected by an agent (and in some cases, a third-party data provider) provided there is an appropriate system in place for the sharing of information between the agent and the withholding agent regarding the payee’s FATCA status and the withholding agent is able to prove that status to the IRS upon request.
 - ***Consolidated Obligations.*** A withholding agent may treat multiple obligations (or accounts) as a single “consolidated” obligation for purposes of sharing documentation (see previous bullet) as well as for the purpose of treating the obligation as a preexisting obligation (see footnote 13 above), but in that event it must treat these multiple obligations as a single obligation for

purposes of satisfying due diligence “reason to know” requirements and various threshold tests under the regulations.

- ***Merger or Bulk Acquisition.*** Generally, a withholding agent acquiring an account in a merger or bulk acquisition of accounts for value is permitted to rely on the *documentation* collected by the predecessor or transferor. In addition, if the acquisition is from a U.S. withholding agent, a participating FFI or a reporting Model 1 FFI that has completed its due diligence requirements,³² the predecessor’s or transferor’s *determination* of the account holders’ chapter 4 status may be relied on for a period of six months, unless the acquirer knows the claim of status is inaccurate or a change in status occurs. After the end of the six-month period, the acquirer must make its own determination regarding the chapter 4 status of the accounts.³³

- ***Fulfilling FATCA Documentation Requirements through an Agent or Introducing Broker.*** The final regulations permit a withholding agent (principal) to use an agent (paying agent) to fulfill its FATCA obligations, provided there is a written agreement between the parties and, if the paying agent will be assuming tax reporting or deposit and payment responsibilities, a notice of the agreement is filed with the IRS. Under this arrangement, which is analogous to the “authorized foreign agent” rules under chapter 3, the paying agent also becomes a withholding agent with its own independent obligation to determine the FATCA status of the payee as it relates to the principal and any action the paying agent takes is imputed to the principal. Under such an arrangement, both the principal and the paying agent are liable for any underwithholding. Under certain conditions involving readily tradable instruments, a withholding agent may also rely on a certification provided by an introducing broker indicating its determination of a payee’s status and indicating that the broker holds valid documentation supporting such status.

³² The final regulations exclude related party transactions from this rule. However, in such transactions, one of the document sharing rules described above, such as the sharing of documents within an expanded affiliated group, may be applicable.

³³ The merger or bulk acquisition rules that apply to participating FFIs are somewhat more flexible. The participating FFI is permitted to treat such accounts as preexisting accounts and is allowed the extended due diligence periods applicable to preexisting accounts, described in the text below, to complete its due diligence. If the acquisition is from a participating FFI or a deemed-compliant FFI that applies the general due diligence standards as a condition to its status, or a USFI, the acquiring FFI generally is permitted to rely on the predecessor’s or transferor’s *determination* of the account holders’ chapter 4 status indefinitely (assuming there is no change in circumstance or actual knowledge to the contrary), provided certain requirements are met, including the transferee FFI testing a sample of the acquired accounts to assess the reliability of the prior determinations and the predecessor or transferor providing a written representation that certain due diligence procedures were conducted.

- **Presumption Rules.** When a withholding agent cannot, prior to payment, reliably associate a payment with valid documentation, the withholding agent may rely on a series of presumptions to establish whether a payee is a U.S. or non-U.S. person and other potentially relevant characteristics. These presumption rules are in a number of significant respects comparable to those that apply under chapter 3. One significant change made by the final regulations is the addition of a so-called “eyeball test” similar to that under chapters 3 and 61, which in many cases allows a withholding agent to establish the status of an undocumented payee (in particular, with respect to its status as a U.S. or non-U.S. person) based on certain readily apparent criteria.

The final regulations retain a rule that requires that a withholding agent, in the absence of adequate documentation, treat payments as made to a nonparticipating FFI account holder of an intermediary if the withholding agent has documentation or documentary evidence that indicates, or the facts and circumstances indicate, that the payee is a bank, broker, custodian, intermediary or other agent, and the withholding agent has no knowledge that the payee is receiving the payments for its own account. This presumption appears to apply even if such intermediaries are participating FFIs or deemed-compliant FFIs, although participating FFIs and registered deemed-compliant FFIs generally are permitted to provide pooled allocation information instead of documentation for each payee.

- **FFI Account Holder Due Diligence Procedures.** Unless it is relying on the due diligence procedures of an applicable IGA, a participating FFI must identify and document the status of each account holder to determine the chapter 4 status of the account – *e.g.*, if the account is a U.S. account, a non-U.S. account, or an account held by a recalcitrant account holder or nonparticipating FFI – under the procedures set forth in the final regulations. Very generally, the rules calibrate the requirements based on the value and risk profile of the account, and by permitting FFIs in many cases to rely on information they already collect. Nonetheless, the rules remain quite complex and burdensome, particularly with respect to the documentation of new entity accounts. The principal rules applicable to FFIs are highlighted below.
 - **FFI Preexisting Individual Accounts.** An electronic search for U.S. indicia³⁴ generally suffices for all accounts with aggregate balances up to \$1

³⁴ In general, an account holder is treated as having U.S. indicia if the information that the FFI is required to review includes (i) designation of the account holder as a U.S. resident or citizen, (ii) a U.S. place of birth, (iii) a current U.S. residence address or U.S. mailing address (including a U.S. post office box), (iv) a current U.S. telephone number (regardless of whether it is the only telephone number included), (v) standing instructions to transfer funds to an account maintained in the United

million;³⁵ accounts aggregating \$50,000 or less (\$250,000 or less in the case of cash value insurance or annuity contracts) need not be searched at all until the account balance exceeds \$1 million.³⁶ High-value accounts (those with balances aggregating over \$1 million) require an enhanced inquiry of relationship managers and, to the extent the information regarding U.S. indicia is not available from the electronic search, review of the current master files and other specified documents that were obtained within the last 5 years.³⁷ As noted above, the diligence procedures for high-value accounts must be completed within one year after the effective date of the FFI agreement (generally December 31, 2014) and two years for all other accounts (generally December 31, 2015).

- ***FFI New Individual Accounts.*** An FFI may generally rely on documentary evidence (including most types of governmental identification) that establishes an individual's status as a U.S. or non-U.S. person, but must also review all information collected with respect to the opening or maintenance of each account for U.S. indicia, including a U.S. place of birth. The due diligence procedures for new individual account openings are only required for accounts aggregating over \$50,000 and must be completed by the earlier of the date a withholdable payment is made or 90 days of the account's

States, (vi) a current power of attorney or signatory authority granted to a person with a U.S. address or (vii) an "in-care-of" address or "hold mail" address that is the sole address the FFI has identified for the account holder (which in some cases is limited to an "in-care-of" address in the United States). If U.S. indicia are found, the final regulations provide a complex set of documentation rules to rebut the resulting presumption of U.S. status. The final regulations relax these rules somewhat as compared to the proposed regulations.

³⁵ If the FFI has previously documented an account holder as a foreign individual for purposes of the chapter 3 QI regime or under the information reporting rules of chapter 61, no electronic search or enhanced review is required. The relationship manager inquiry, however, is still required.

³⁶ In applying these thresholds (and the entity thresholds described below), all accounts held by the FFI or its affiliates for the account holder must be aggregated if, but only if, (i) the FFI's computerized systems link the accounts by reference to data such as a client number or taxpayer identification number, and the systems permit the balances of such accounts to be aggregated; (ii) the relationship manager knows that the accounts are directly or indirectly owned, controlled or established (other than in a fiduciary capacity) by the same person, or otherwise has associated the accounts with one another through applicable identification numbers (or typically would do so under applicable procedures); or (iii) the FFI treats the accounts as "consolidated obligations" for purposes of (a) sharing documentation between the obligations or (b) treating a newly opened account as an extension of a preexisting account where it is entitled to rely on the AML due diligence on the preexisting account.

³⁷ If, however, the FFI's electronically searchable information contains the specified account holder information, there is no requirement to undertake the enhanced procedures.

opening. Under certain circumstances, an FFI may establish an account holder's status as a foreign person based on information provided by a third-party credit agency.³⁸

- ***FFI Entity Accounts.*** The regulations prescribe specific documentation requirements for the numerous categories of entity accounts, with more relaxed requirements for preexisting accounts and offshore accounts. Nonetheless, in many cases it will be difficult for FFIs to satisfy these requirements from readily available information, and therefore it is quite likely that FFIs will need to obtain certifications or other information from the holders of many new entity accounts. No review is required of preexisting entity accounts with balances of \$250,000 or less until the account balance exceeds \$1 million. As noted above, the diligence procedures for preexisting entity accounts must be completed within six months of the effective date of the FFI agreement (generally June 30, 2014) for prima facie FFIs, and two years for the remainder of accounts (generally December 31, 2015). Diligence for new entity accounts must be completed by the earlier of the date a withholdable payment is made or 90 days of the account's opening.
- ***Entity Account Look-Through Rules.*** The final regulations make clear that in addition to documenting the entity account holder, a participating FFI is also required to document the payee, if different, to the extent necessary to determine whether withholding applies when a U.S.-source withholdable payment is made. This means that an FFI will need to identify and document the partners, owners, or beneficiaries of a flow-through entity that is the account holder if it is receiving a withholdable payment.
- ***Coordination with IGAs.*** An FFI's due diligence obligations under the Model 1 and Model 2 IGAs generally tracks the account thresholds and deadlines set forth above, although the final regulations present the requirements in a more detailed and technical manner.³⁹
- ***Onshore Accounts of U.S. Withholding Agents (Including U.S. Branches of Foreign Banks).*** In general, U.S. withholding agents, including U.S. branches of

³⁸ However, to rely on this rule, the account holder must provide a residence address outside the United States as part of the FFI's account opening procedures, the third-party credit agency must verify the account holder's claimed residence status with at least one specified government data source, and the FFI must rely on information provided from the third-party credit agency for purposes of satisfying its AML due diligence.

³⁹ One notable difference is that the IGAs do not have a shorter, 6-month due diligence period for preexisting accounts of prima facie FFIs.

foreign banks that elect to be treated as U.S. persons, will need to obtain a new IRS Form W-8, W-9 or other withholding certificate from virtually all entity accounts satisfying the conditions of the new rules. However, in many cases transitional exceptions will apply for payments made prior to January 1, 2017 with respect to preexisting accounts, so long as the U.S. withholding agent has available to it (or is provided by the account holder) the necessary information, or in some cases documentation, regarding the account holder's status. In any event, U.S. withholding agents generally will need to obtain information regarding all substantial U.S. owners of passive NFFEs or a certification that the entity does not have substantial U.S. owners, although that requirement also is subject to transitional relief with respect to preexisting accounts having balances of \$1 million or less. In such cases, withholding agents generally are permitted to rely on their AML due diligence review to identify any substantial U.S. owners. For new accounts and those not covered by the transitional relief, the documentation generally will need to be in place by December 31, 2013.

5. **"All or None" Rule for FFI Groups and Limited Relief for Foreign Legal Conflicts.**

Subject to IGAs, the final regulations maintain the proposed rules that generally provide that an FFI can be a participating FFI only if every member of its expanded affiliated group also is a participating FFI or is a deemed-compliant entity. The regulations provide limited transitional relief from this requirement in the case of FFIs (or their branches) that cannot, under local law, comply with FATCA's reporting, withholding or account closure requirements. Under this special "limited FFI" rule, the affected FFI (or branch) must (i) agree to perform account holder due diligence, retain account holder documentation and report with respect to U.S. accounts to the extent it is permitted to do so; (ii) agree not to open U.S. accounts or accounts for nonparticipating FFIs;⁴⁰ and (iii) agree that it will be treated as a nonparticipating FFI with respect to any payments it receives from other withholding agents.

The special rules for limited FFIs and limited branches apply only through December 31, 2015. Thereafter, all of an FFI's branches and affiliates will be required to be participating FFIs or deemed-compliant entities in order for the FFI to qualify as a participating FFI. Moreover, the limited FFI and limited branch rules apply only if one

⁴⁰ Thus it would appear that the limited FFI rule may be unavailable for FFIs that operate in jurisdictions that have "requirement to serve" legislation or similar rules requiring that financial institutions provide certain basic services to any resident upon request.

or more affiliated FFIs (in the case of the limited FFI rule) or one or more branches (in the case of the limited branch rule) are participating FFIs.⁴¹

By contrast, the IGAs make the limited FFI and limited branch exceptions permanent, provided that certain conditions are met.⁴² Treasury and the IRS declined to adopt such a permanent exception in the final regulations, indicating that IGAs are the appropriate vehicle for providing relief. This approach seems short-sighted since it appears unrealistic to expect that every single jurisdiction will enter into an IGA and equally unrealistic to expect that multinational financial groups with an FFI affiliate or branch in countries that have not entered into IGAs will be forced to forfeit their participating FFI status after 2015 if the group has an FFI affiliate or branch in a jurisdiction that has restrictions on compliance with FATCA and has not entered into an IGA.

6. FFI Portal and GIINs.

The IRS intends to set up a secure online web portal, called the FATCA Registration Portal (the “Portal”). An FFI will use the Portal to electronically enter into an FFI agreement and register its FATCA status with the IRS (including as a registered deemed-compliant FFI or as an FFI that reports under a Model 1 IGA). Foreign branches of U.S. financial institutions that report under a Model 1 IGA will also be required to register via the Portal.

Once an FFI has registered its FATCA status on the Portal, it will receive a Global Intermediary Identification Number (“GIIN”). An FFI will be able to avoid FATCA withholding by providing its GIIN to a withholding agent. The withholding agent will confirm the FFI’s FATCA status by checking the FFI’s GIIN against a list published by the IRS. An FFI must register with the IRS by October 25, 2013 in order to guarantee that its GIIN will be included on the initial GIIN list, to be published in December 2013.⁴³ If the IRS terminates an FFI’s FFI agreement, or otherwise determines that it does not qualify for registered deemed-compliant status, the FFI will be removed from the GIIN list. Withholding agents will be required to treat such an FFI as no longer qualifying as a participating FFI or registered deemed-compliant FFI within one year of

⁴¹ The final regulations contain an exception permitting an FFI that is a QI to become a limited FFI notwithstanding that none of its affiliates can comply with the requirements for becoming a participating FFI.

⁴² The final regulations provide that the all-or-nothing rule does not affect the status of a participating FFI or deemed-compliant FFI that meets such status pursuant to an IGA.

⁴³ Under a transition rule, a withholding agent will not have to confirm the GIIN of an FFI that reports under a Model 1 IGA prior to January 1, 2015, unless the withholding agent does not have a permanent residence address for the FFI in the relevant Model 1 IGA country.

the date it is removed from the list. Thus, withholding agents effectively will be required to reconfirm the status of their FFI account holders and payees at least annually.

It is anticipated that FFIs will be able to register on the Portal by July 15, 2013.⁴⁴ FFIs will also be able to use the Portal to manage the registration of members of their expanded affiliated groups. The IRS has announced its intention to publish a Revenue Procedure prior to this first registration date that details the terms of the FFI agreement. If a participating FFI receives a GIIN before January 1, 2014, the effective date of its FFI agreement will be December 31, 2013.

QIs (including foreign branches of U.S. financial institutions that are QIs) will also use the Portal to renew their QI status. The Revenue Procedure on chapter 4 terms and conditions will also include modifications to be made to QI agreements in order to take into account chapter 4 requirements. When a QI renews its QI status on the Portal, it will also receive a GIIN. The IRS anticipates that a QI will provide its GIIN to a withholding agent, instead of its QI EIN. Withholding partnerships (“WPs”) and withholding trusts (“WTs”) will also use the Portal to renew their WP or WT status, and will receive GIINs to use in lieu of their WP EINs or WT EINs.

The IRS intends that a responsible officer will use the Portal to make the required certifications relating to an FFI’s compliance with the FATCA due diligence requirements and maintaining a FATCA compliance program, as described in Section IV.11 below.

7. Consolidated Compliance for FFI Affiliated Groups and Sponsored Funds.

The final regulations contain helpful rules permitting some or all of the participating FFIs that are members of an expanded affiliated group to elect to be part of a consolidated compliance program, whereby one member of the group would assume responsibility to act on behalf of the electing members under the conditions set forth in the regulations.

Similarly, compliance for certain investment entities, controlled foreign corporations and closely held FFIs can be streamlined by having a “sponsoring” entity (*e.g.*, a fund manager, trustee, or managing partner) agree to perform all due diligence, withholding, reporting and other requirements that the “sponsored” entity would have been required to perform if it were a participating FFI. This approach may be attractive for private equity fund, hedge fund and mutual fund groups that have numerous distinct investment entities that are under the control of a single fund manager.

⁴⁴ It is anticipated that sponsoring entities will be able to provide sponsored FFI information and obtain GIINs for each sponsored FFI via the Portal beginning no later than October 15, 2013.

8. U.S. Banking Branch of a Participating FFI.

A U.S. branch of a bank or insurance company that is a participating FFI or deemed-compliant FFI is treated as a U.S. person for purposes of chapter 4 if the branch enters into an agreement to be treated as such with its counterparty for purposes of chapter 3 and provides either a Form W-8 or an EIN and a GIIN. Alternatively, in response to comments, the final regulations also allow a withholding agent to presume that a payment to a U.S. branch of a bank or insurance company that is a participating FFI or deemed-compliant FFI is effectively connected with the conduct of a U.S. trade or business (as in the case of a similar chapter 3 presumption) and thus exempt from FATCA withholding, but only if the withholding agent obtains the branch's EIN and the home office's GIIN. Foreign banks had requested that the regulations permit such a presumption in order to enable their U.S. branches to interact with their U.S. counterparts on the same basis as their U.S. banking competitors. It remains to be seen whether this will be the case given the need for the counterparties to have the branch's EIN and the home office's GIIN. The final regulations do not impose any formal requirements regarding the manner in which the EIN and GIIN must be obtained, but in any event, at least some of the information would typically need to be provided by the branch.

The regulations also contain guidance regarding the applicable reporting and withholding rules for U.S. branches that are treated as U.S. persons that integrates the FATCA rules with the U.S. reporting and withholding rules to which they are subject, and also requires a U.S. branch that is treated as a U.S. person to apply the due diligence standards applicable to onshore obligations of U.S. persons. A branch that is not treated as a U.S. person presumably is subject to the due diligence, reporting and withholding rules applicable to FFIs. Since a U.S. branch's status as a U.S. person is specific to its relationship with a particular withholding agent, U.S. branches that do not enter into agreements with each and every withholding agent presumably will be subject to different due diligence, reporting and withholding rules depending on the particular payments, which will be burdensome and confusing.

9. Foreign Branches of U.S. Financial Institutions.

The final regulations define a participating FFI to include a QI branch of a U.S. financial institution, unless the branch is a reporting Model 1 FFI. However, Model 1 IGAs are generally expected to apply to local branches of institutions resident outside the partner jurisdiction, and thus under a Model 1 IGA, a local branch of a U.S. financial institution would generally be treated as an FFI. The final regulations also contain a rule that a foreign branch of a USFI acting in its capacity as a QI is treated as a foreign intermediary. Because chapter 3 rules treat foreign branches of USFIs as U.S. persons, these branches will be subject to inconsistent treatment under chapters 3 and 4. In the preamble to the final regulations, the IRS recognized that such inconsistency could lead

to duplicative reporting, but the regulations do not provide interim relief while the IRS considers the issue.

10. Reporting.

The reporting obligations in the final regulations generally track the reporting obligations in the proposed regulations. For example, the final regulations retain the requirement that the financial institution maintaining the account report the account; the election to report accounts on a branch-by-branch basis; the election for an FFI to comply with reporting requirements under chapter 61 as if it were a U.S. payor rather than comply with the standard FATCA reporting requirements; and the requirement to retain records collected in the ordinary course of business for any accounts held by recalcitrant account holders that are U.S. persons.

The final regulations require that a participating FFI report the average account balance or value of a reportable account, to the extent the FFI reports such average balances or values to the account holder; otherwise, the FFI is required to report the year-end account balance or value.

The final regulations retain the proposed regulations' rule that permits an FFI that is a QI to simplify the withholding (and thus, the reporting) obligations that otherwise would be imposed on it by electing to be subject to withholding on payments of U.S.-source FDAP it receives, to the extent those payments are allocable to recalcitrant account holders or nonparticipating FFIs. This election may be made without the consent of any withholding agent that is making a payment to the electing FFI. The final regulations reserve on the application of this election to payments of gross proceeds, and thus it is possible that the IRS will in the future allow FFIs that are QIs to make a similar election to be withheld upon with respect to payments of gross proceeds from any property of a type that can produce U.S.-source interest or dividends.

The final regulations provide that participating FFIs will comply with their annual reporting obligations with respect to accounts that they maintain on new Form 8966. Withholding agents' reporting of withholdable payments and foreign passthru payments will be made on an updated Form 1042-S.

The final regulations do not coordinate the chapter 4 reporting requirements with those applicable under chapters 3 and 61, although the preamble indicates that Treasury and the IRS intend to issue future guidance on this issue in order to reduce or eliminate duplicative reporting. In addition, the reporting procedures implemented under an IGA, in particular a Model 1 IGA, may also differ from the reporting procedures specified in the final regulations.

11. FFI Agreement Verification and Certification Requirements.

- ***Verification of Compliance Every 3 Years.*** A participating FFI will be required to adopt a compliance program, overseen by a responsible officer, which will include policies, procedures and processes sufficient for the participating FFI to satisfy its obligations under its FFI agreement. As discussed in Section IV.7 above, an expanded affiliated group may elect to have a consolidated compliance program that will cover some or all of its FFIs.

The responsible officer will be required to review the FFI's compliance program every three years and provide a certification to the IRS confirming that the FFI has established a compliance program that provides effective internal controls and that the FFI has not experienced any material failures in complying with its FFI agreement or that any material failures have been remediated and steps have been taken to prevent their reoccurrence. If the responsible officer cannot make this "no material failure" certification, he or she must provide a qualified certification that identifies any event of default or material failure and provide information regarding the actions the FFI will take to correct each such failure. Material failures include the deliberate or systemic failure of the FFI to comply with its reporting and withholding obligations under the FFI agreement, sanctions from a government regulator for noncompliance with its AML due diligence procedures, and a potential future tax liability related to noncompliance with the FFI agreement for which the FFI establishes a tax reserve or provision for financial statement purposes.

The final regulations helpfully provide that the responsible officer may delegate all or a portion of the implementation and oversight of the FFI's compliance program, although the responsible officer ultimately will be responsible for such program, and for making the required certifications to the IRS.

- ***Initial 2-Year Certification of Due Diligence.*** In addition to the periodic certifications described above, the responsible officer will be required to provide a certification to the IRS regarding the FFI's compliance with the FFI agreement's due diligence procedures, no later than 60 days following the second anniversary of the effective date of the entity's FFI agreement. The responsible officer also must certify, to the best of his or her knowledge after conducting a reasonable inquiry, that the FFI did not have any formal or informal practices or procedures to assist account holders in avoiding FATCA. The "reasonable inquiry" must include a review of the FFI's procedures and a written inquiry to personnel responsible for new customers as to whether such personnel engaged in such practices.

- ***IRS Requests.*** In addition to the compliance certification requirements in the final regulations (as well as any additional requirements that may be spelled out in FFI agreements,⁴⁵ the IRS may request additional information regarding an FFI's compliance, *e.g.*, a copy of the policies and procedures for the compliance program or written reports documenting the periodic review, although the preamble to the final regulations indicates that the IRS does not expect to make such requests routinely. Unlike the compliance process for QIs, third-party audits of an FFI's compliance generally are not required, although the IRS has reserved the right to request that a third-party auditor perform certain review procedures.
- ***Events of Default, Remediation and Termination.*** The final regulations make it clear that the IRS intends to terminate FFI agreements for noncompliance only under extraordinary circumstances, and that FFIs will be provided an opportunity to address events of default or other acts of noncompliance under their agreements. Thus, if the IRS becomes aware of an event of default, it will provide notice to the FFI and will provide the FFI with a specified period of time to remediate the event of default. The IRS, in its discretion, may terminate the FFI's agreement if the FFI does not remedy the event of default within the specified time period, although an FFI is permitted to request reconsideration of a notice of default or a termination of its agreement.

An event of default will generally occur if the participating FFI fails to perform material due diligence, reporting or withholding obligations under the FFI agreement. The final regulations also include a list of occurrences that will give rise to an event of default. A number of the enumerated events of default include failures to address issues that could prevent an FFI agreement from being fully effective, including an FFI's failure to "significantly reduce, over a period of time" the number of account holders or payees that it must treat as recalcitrant account holders or nonparticipating FFIs. Similarly, an FFI's failure to obtain waivers of restrictions on reporting or withholding from account holders or, alternatively, to close the affected accounts, is an event of default. Other enumerated events of default include failure to maintain a compliance program or to conduct the required periodic reviews or provide the required certifications; failure to timely remedy a material failure; making incorrect claims for refund of FATCA taxes withheld; and failure to cooperate with an IRS request for information or making a fraudulent statement or misrepresentation to the IRS.

⁴⁵ The IRS has not yet released a form of FFI agreement, and the preamble to the final regulations indicates that additional guidance regarding the compliance requirements may be provided in the FFI agreements.

12. Escrowed Withholding, Underwithholding, Overwithholding and Refunds.

The final regulations permit withholding agents to escrow amounts that may be subject to withholding for up to a year pending a determination of the relevant facts. The final regulations also allow a withholding agent to reimburse payees or account holders during a limited time period for overwithheld amounts out of funds that the withholding agent otherwise is required to deposit with the IRS. Alternatively, the final regulations provide for a collective refund process⁴⁶ whereby a participating FFI or a reporting Model 1 FFI may request a credit or refund from the IRS on behalf of an account holder or payee. Although this process is optional for the FFI, if it does not apply for such a refund, it is required to file and provide to an account holder or payee that has so requested (or ensure that another withholding agent does so) a Form 1042-S to ensure that the account holder or payee is able to document the overpayment of tax and seek a refund on its own behalf.⁴⁷

A withholding agent that has underwithheld with respect to FATCA withholding tax may apply the procedures used for chapter 3 withholding in order to satisfy its FATCA withholding obligations with respect to a payee or beneficial owner.

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Please feel free to contact any of your regular contacts at the firm or any of our U.S. partners and counsel listed under Tax in the “Practices” section of our website (<http://www.clearygottlieb.com>) if you have any questions.

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⁴⁶ This collective refund process is comparable to a similar optional process that is set forth in QI agreements.

⁴⁷ The chapter 3 withholding tax rules do not include a similar obligation to provide individual Forms 1042-S, which has created problems for some taxpayers who have received income through pooled accounts and have been unable to obtain refunds because of an inability to document their payment of tax. However, the new provisions requiring FFIs to provide individual Forms 1042-S may allow taxpayers to obtain the required documentation for chapter 3 purposes as well.

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