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Recent Developments Under FATCA, U.S. Withholding Tax, and Global Information Reporting

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The *Foreign Account Tax Compliance Act* (FATCA) has been gradually implemented over the course of several years, starting with its enactment in 2010.

FATCA was primarily enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. FATCA withholding became effective in 2014, and the law has come into force over time, using staggered effective dates. Due to the complexity of the legislation, multiple delays and transitional rules regarding effective dates for various aspects of the law have been provided through ongoing IRS guidance.

FATCA levies a 30 percent withholding tax on U.S.-source payments of fixed or determinable, annual or periodical (FDAP) income unless its prescriptive requirements regarding payee documentation are met. On Dec. 30, 2016, the IRS released additional final FATCA regulations. These additions introduced changes regarding documentation of sponsored entities and the associated registration process on behalf of a sponsoring entity. Beginning in 2019, the withholding tax of 30 percent will apply to gross proceeds from the sale or other disposition of any property of a type that can produce U.S.-source FDAP income, further expanding the law's reach.

Intergovernmental Agreements

As of this writing, 113 countries had entered into intergovernmental agreements (IGAs) with the United States under FATCA. IGAs are contractual agreements that require countries to facilitate the reporting of information mandated under FATCA by their resident companies, either directly or indirectly, with the U.S. government.

As a group, IGAs do the following:

- Provide an agreed set of definitions and procedural requirements, including the treatment of resident entities, associated duties, and the prerequisites for certain entities to be exempt from registration, under FATCA.
- Set thresholds on the values of accounts that are required to be documented and reported.
- Provide guidance and safe-harbor rules regarding information that is required to be obtained and reviewed by the resident payer.
- In certain instances, extend the deadline for FATCA reporting for resident entities.

Treatment of Sponsored Entities

Notice 2015-66 delayed the effective date for the requirement of sponsored entities to obtain their own global intermediary identification number (GIIN) until Dec. 31, 2016. A sponsored entity is one that has contracted with another entity to perform its FATCA-related duties. The final regulations issued in T.D. 9809 extended the requirement for sponsored entities to obtain their own GIIN three months, through March 31, 2017. Because the IRS has not extended the exception beyond March 31, 2017, a withholding agent that does not have the GIIN of a sponsored entity must withhold 30 percent on withholdable payments made after this date. As such, withholding agents should be in the process of updating their withholding certificates for sponsored entities, if they have not already done so.

Reporting on Gross Proceeds

Under the recently released final regulations (T.D. 9809), withholdable payments under FATCA will be expanded to include payments of gross proceeds from the sale or other disposition of any property of a type that can produce U.S.-source interest or dividends. Reporting of gross proceeds stemming from any sale or disposition of property subject to FATCA reporting was slated to begin for transactions occurring after Jan. 1, 2017. However, the IRS has delayed the effective date of this requirement until at least Jan. 1, 2019, when withholding on those transactions is currently scheduled to begin for sales of property subject to FATCA occurring after Dec. 31, 2018.

Gross proceeds: Gross proceeds in this context are defined under FATCA as the total amount realized as a result of the sale or other disposition event. To the extent a clearing organization settles sales and purchases of securities between members of an organization on a net basis, the gross proceeds from these sales or dispositions are limited to the net amount paid or credited to that member's account, as allocated from the sale or disposition.

Property: Property subject to gross proceeds reporting includes any type of property that can produce interest or dividends that would be U.S.-source under the Code. This determination is made irrespective of whether interest or dividends were actually paid while the property was held. Furthermore, such "Chapter 4 property" includes contracts producing U.S.-source dividend-equivalent payments, regardless of whether the non-U.S. persons are otherwise subject to federal income tax. Finally, regulated investment company distributions are included in gross proceeds to the extent the payment is attributable to property that produces U.S.-source interest or dividends designated as capital gain dividends.

Foreign pass-through payments: Notice 2015-66 also provides additional guidance for foreign pass-through payments. Under FATCA, participating foreign financial institutions (FFIs) must agree to withhold at the 30 percent rate on foreign pass-through payments made to recalcitrant account holders and nonparticipating FFIs. Under current guidance, withholding does not apply to foreign pass-through payments until 2019 at the earliest. The definition of foreign pass-through payments is still being developed and is reserved under the current regulations. In general, however, the scope of foreign pass-through payments is exceptionally broad and, as such, includes all withholdable payments, including other payments attributable to withholdable payments. Although the focus on foreign pass-through payments is primarily on U.S.-source income, it is expected that certain non-U.S.-source income may also be included. It is important to note that one of the primary purposes behind the foreign pass-through payment concept under FATCA is to preclude an FFI from serving as a "blocker" for U.S. persons attempting to avoid U.S. tax via indirect investments in U.S. assets.

Other U.S. Withholding Tax Developments

The final regulations issued in T.D. 9809e provided additional guidance regarding the requirement to specify the limitation-on-benefits (LOB) provision that an entity is relying upon in making a treaty claim for reduced withholding under Chapter 3 of the Code. Specifically, under Temp. Regs. Sec. 1.1441-6T, for withholding certificates issued after Jan. 6, 2017, Form W-8BEN-E, "Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)," Form W-8EXP, "Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding and Reporting," and Form W-8IMY, "Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding and Reporting," must indicate the precise LOB provision within the relevant treaty on which the foreign recipient is relying in making its treaty claim. For withholding certificates provided before Jan. 6, 2017, entities can continue to rely on these certificates through 2018.

Thus, as a practical matter, all withholding agents will be required to collect new withholding certificates from their foreign payees and investors during 2018 to have the requisite LOB documentation in hand to continue to make withholdable payments at less than the 30 percent standard rate where a treaty applies. The IRS released a revised version of Form W-8BEN-E in April 2016 that provides an expanded Part III, "Claim of Tax Treaty Benefits," as the primary means of complying with this requirement. The IRS released revised versions of Forms W-8EXP and W-8IMY in September 2016 and June 2017, respectively.

The requirement to provide a taxpayer identification number (TIN) to enjoy U.S. tax treaty benefits also remains in flux. Under Regs. Sec. 1.1441-6, a TIN is required to be provided by the foreign recipient to receive a reduced rate of withholding, except in cases of actively traded securities, for which no TIN is required. Current regulations permit a foreign TIN to be provided in instances when a TIN is required, as opposed to a U.S. TIN. Moreover, for 2017, the IRS further relaxed this requirement via temporary regulations for payments to foreign individuals, thereby delaying this requirement until at least Jan. 1, 2018. Nonetheless, under regulations in effect as of this writing, the IRS will require the provision of foreign TINs for payments made after 2017, to eventually share information with taxing authorities in other jurisdictions.

Lastly, the IRS also published new guidance on the qualified intermediary (QI) regime in late December 2016. As a result of the new QI agreement released at that time, all QIs needed to reapply for QI status as of March 31, 2017, to have their new QI agreement effective as of Jan. 1, 2017. Now that the deadline for QI agreement renewals has passed, the focus has returned to nonqualified intermediaries (NQIs), many of which are being pressured by their upstream counterparties to become QIs. Many of these NQIs have traditionally opted to suffer the full 30 percent withholding tax under Chapter 3 or 4, which is levied on U.S. withholdable payments, rather than disclose the ultimate beneficiaries of those payments.

Whether by design or unintentionally, many NQIs did not comply with the U.S. tax regulations' requirement to issue Forms 1042-S, "Foreign Person's U.S. Source Income Subject to Withholding," to their investors and account holders. Due to this implied lack of compliance and potential for those prone to evade tax to employ NQI structures, many upstream counterparties have mandated that those customers obtain QI status as soon as possible or risk cessation of the financial relationship. These upstream counterparties are essentially acting in their own best interests to minimize the associated reputational risk that might arise from continuing relationships with undocumented indirect account holders.

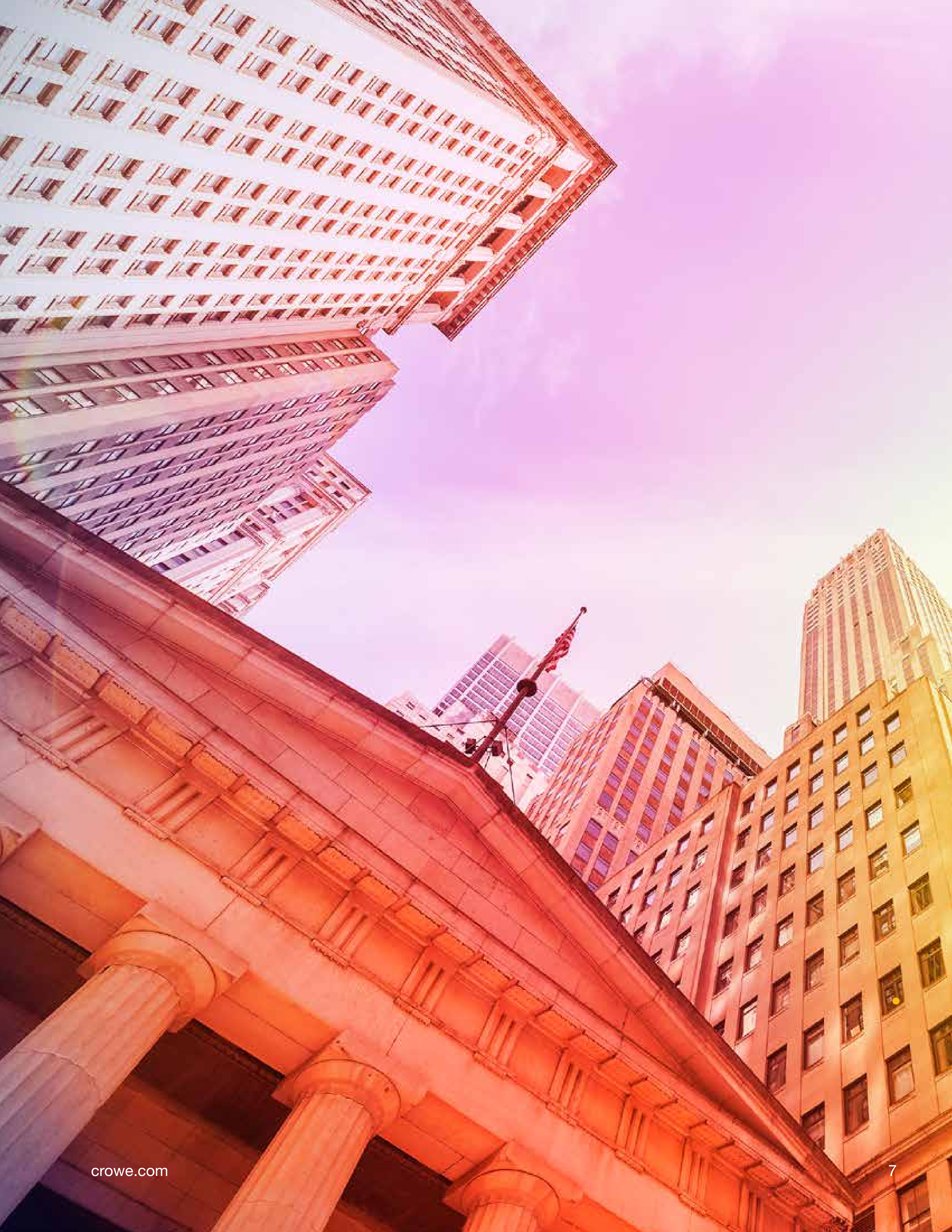
OECD's Common Reporting Standard

In 2013, the G-8 and G-20 commissioned the Organisation for Economic Co-operation and Development (OECD) to create a platform similar to FATCA for the automatic exchange of information. The result was the development of the common reporting standard (CRS), which was initially effective as of 2016 in 50 jurisdictions. Reporting is on a calendar-year basis and is made electronically to the tax authority of the jurisdiction in which the reporting financial institution is based. Of particular note is that traditional "tax haven" jurisdictions such as Bermuda, the British Virgin Islands, the Cayman Islands, and even Panama are participating in the effort.

Unlike the FATCA regime to date, the information exchanges will be truly reciprocal with other jurisdictions and will commence in September 2017 for the early-adopting jurisdictions. As of this writing, more than 100 jurisdictions have signed on to the CRS by executing multilateral competent authority agreements (MCAAs). Unlike FATCA, however, the CRS does not include a withholding tax or penalty component on payments. Rather, the home country of reporting entities will be able to assess penalties on those financial institutions that do not comply, including the revocation of a license to do business. The United States has opted not to participate in the CRS at this time and is continuing with FATCA instead. This position has led to some tax advisers' branding the United States a relative tax haven, given the tendency under FATCA to require less overall reporting than the CRS.

The information required to be reported under the CRS includes name, address, TIN(s), date and place of birth (for individuals), account numbers, and account balances or values, as well as interest, dividends, other income, and gross proceeds, where applicable. In recognition of the administrative costs otherwise created by differing reporting systems, the OECD has chosen a highly standardized approach in designing the CRS. Nonetheless, each signatory jurisdiction can make certain adjustments in its local legislation and system requirements, which has introduced some complexities in the actual implementation of the CRS.

As a result of the CRS, an additional wave of tax compliance is now sweeping the world, much as FATCA and the IRS's offshore initiatives have done for U.S. persons in recent years. The confluence of technology and tax legislation has reached new heights in the current decade, ushering in a new world order in the battle against global tax evasion, which seems to promise ever-greater transparency.



Learn More

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