

The widespread reach of FATCA

How will it affect your business?

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The short answer



FATCA, the Foreign Account Tax Compliance Act, was enacted in 2010 to prevent and detect offshore tax evasion. Based on the name and a quick reading of the rules, FATCA seems to be directed at financial institutions. So, many global companies outside the financial services industry mistakenly believe that they are not affected. However, upon closer review, many realize the surprising fact that they have entities in their worldwide network falling under the purview of FATCA, or have operational areas that make or receive payments subject to FATCA.

Multinational enterprises that are withholding agents are already currently obligated to report, withhold on payments, and document payees, but FATCA requires changes to these activities. FATCA mandates that multinational businesses evaluate entity payees differently, engage in withholding on certain gross proceeds transactions (a change from historic processes), as well as report different information to the Internal Revenue Service (IRS).

So, the important analysis is to determine how FATCA's complex regime will affect your organization and what changes and new steps are required. This demands understanding the types of entities in your company's organizational structure and which payment types create new or different obligations.

Now is the right time to learn more and take action

The withholding provisions of FATCA are scheduled to begin in January 2014. Multinational businesses that have not already begun to assess the FATCA requirements, determine their specific impact, and create a customized plan to comply may be falling behind. Compliance with FATCA may require changes to existing systems and processes across business units and regions, the renewal of policies and day-to-day practices, and new tasks such as registering with the IRS. A variety of adverse consequences, both financial and resource related, may arise if action is not taken soon enough.

What are some specific compliance obligations?

Beginning on January 1, 2014, FATCA imposes new registration, due diligence reviews, information reporting, and tax withholding obligations on entities that qualify as foreign financial institutions (FFIs). By as early as October 2013, legal entities with FFI characteristics must determine whether they are, in fact, FFIs and should register with the IRS.

Multinational corporations should examine their treasury centers, retirement funds, and holding companies, just to name a few examples, to ensure that they do not meet the definition of an FFI. Properly identifying the FATCA status of each entity in a large organization is expected to take significant time and effort, e.g., the final FATCA regulations

impose several different income and asset tests.

Obligations also are imposed on payors of US source fixed or determinable, annual or periodical (FDAP) income, which include many multinational corporations. They must have processes and procedures in place to identify and categorize non-US payees for FATCA purposes, report, and potentially apply 30% withholding tax to avoid being liable for the withholding tax and potential penalties. Even if a foreign entity is not an FFI, FATCA still requires the recipient of a US source payment to establish its FATCA status with appropriate documentation.

The regulations also extend existing reporting and withholding requirements and impose a new withholding tax on FFI entities that do not report certain information regarding their US accounts to the IRS. This new withholding tax also is imposed on certain nonfinancial foreign entities (NFFEs) that do not provide information on their substantial US owners to a withholding agent.

What exemptions apply?

FATCA contains several important exemptions. Although they are incredibly useful, they add complexity. As an example, FATCA withholding should not apply where the payee provides to the withholding agent the appropriate documentation that demonstrates that the payee is not subject

to withholding. Even though withholding under FATCA will not apply, reporting is required. The withholding agent must also evaluate whether reporting and withholding apply under current information reporting rules.

NFFEs that either have no substantial US owners or who identify these owners to withholding agents should not suffer withholding. Nor should NFFEs that are deemed to represent a low risk of US tax evasion, such as publically traded companies and their affiliates, and those engaged in active trades or businesses. A withholdable payment to a documented US entity is not subject to the 30% tax, but reporting will apply.

What are some actions to think about?

Multinational corporations need a FATCA compliance program to ensure that all necessary FATCA classifications, documentation, monitoring and reporting are undertaken. This process ought to be documented in a series of policies and procedures ensuring that the process has controls that can be replicated and tested. Further, the program should highlight changes in business practices that may be necessary for FATCA compliance and is intended to provide comfort to senior management that all areas of the organization have been reviewed according to requirements.

More details



FATCA's broad application

A bird's-eye view of how it works

The US Congress enacted FATCA to ensure that income earned and assets held by US persons in offshore accounts or indirectly through ownership of foreign entities is reported to the IRS. *But how does FATCA achieve this?*

A core element of its design requires a broad group of US and foreign persons to **identify and document payees** differently and ultimately **disclose new**

and different information to the IRS.

The FATCA legislation (new Chapter 4 of the Internal Revenue Code) describes the broad requirements and policy, but delegates to the US Department of the Treasury (Treasury) and IRS the obligation to narrow FATCA's scope and promulgate the exact path to compliance. The Treasury and IRS have done so through a series of notices, proposed regulations, and final regulations which were issued in January of this year.

In order to mitigate certain foreign legal impediments to FATCA compliance, intergovernmental agreements (IGAs) also have been negotiated (with more to come) between the Treasury and foreign governments. Under certain IGAs, including most of the IGAs signed thus far, information will be exchanged directly between the IRS and local governments. This obligates entities in IGA jurisdictions to report information to their government that may not have been required or permitted in the past.

FATCA compels compliance by imposing **withholding obligations** that offer a significant financial incentive to stakeholders to do their part to comply. Specifically, FATCA generally requires multinational businesses and FFIs to withhold 30% on payments that meet the definition of a ‘withholdable payment’ when made to non-compliant payees. The term ‘withholdable payment’ generally refers to the gross amount of most types of US source income, such as interest or dividends on US securities, as well as gross proceeds from the sale or redemption of US securities.

However, the Treasury and IRS have narrowed the scope of FATCA withholding to apply to specific types of entities identified in the legislation and those persons that pose a significant risk of tax evasion. As an example, withholding does not apply to certain payments made in the ordinary course of a trade or business, such as most service charges. To utilize any FATCA exception, documentation of the character and source of payment is required. Additionally, reporting will be required despite the withholding exceptions.

Key takeaway:

Assessing FATCA’s impact will require identifying whether an IGA may apply to the entity or payment stream at issue. Provisions in the final regulations or any other IGA that provide more favorable results may be utilized. This will likely increase the complexity of the process, due in part to the multiple paths to compliance (e.g., regulations or an IGA). The regulators have focused on having consistent requirements in each IGA however, there are noticeable differences in the agreements signed to date.

Three ways FATCA may apply to your business

FATCA requirements are not limited to the financial services industry. Many activities of nonfinancial businesses will trigger these new compliance obligations. Below is a high-level, but clearly nonexhaustive explanation of situations in which FATCA may apply to your company.

1. You have FFIs within your group

FATCA imposes the most significant obligations on FFIs. Companies engaged in nonfinancial businesses may think that few or none of their foreign entities constitute an FFI. However, the definition of an FFI is broad and includes more types of entities than one might expect – an unwelcomed result for companies that are not prepared. Although the rules provide various exceptions, the following are types of entities that may qualify:

- **non-US retirement funds and foundations.** Non-US retirement funds whose gross income is primarily attributable to investing, reinvesting, or trading in financial assets and are professionally managed by another entity are classified as investment entities. However, certain retirement funds entitled to receive benefits under a tax treaty are examples of retirement funds that are not FFIs under FATCA.
- **treasury centers, holding companies, and captive finance companies.** These types of entities are specifically identified in the definition of an FFI. Among the activities relevant in assessing whether a legal entity is treated as an FFI are:
 - cash pooling
 - securitization and factoring activities

- hedging activities (including whether hedges are entered into with affiliates or with ‘customers’)
- customer financing operations
- offshore cash deployment and investment strategies
- in-house bank and external credit or ‘banking’-type operations.

- **special purpose entities and banking-type subsidiaries.** Although frequently utilized to access lower cost sources of funding for operations or acquisitions, the mix of activities in which they are engaged and how income is derived may cause them to fall within the FFI definition.
- **captive insurance companies.** Generally, captive insurance companies may not be FFIs for FATCA purposes because they do not have any cash value or annuity contracts. However, such captives should still evaluate their business operations to determine if they qualify as another category of FFI. These other categories may include: (1) depository institutions, (2) custodial institutions, (3) investment entities, and (4) certain holding companies and treasury centers.

As such, many factors and exemptions need to be analyzed to determine if these entities fall under the definition of an FFI.

Key takeaway:

If an entity qualifies as an FFI, the FATCA rules impose the same types of obligations as the current rules under Chapters 3, 24, and 61. But they are expanded, for example, with new due diligence procedures to identify US account holders or investors. Other FFI requirements include, but are not limited to, registering with the IRS and certifying FATCA compliance.

2. Your company is making US source cross border payments (you're the payor)

FATCA generally applies when a multinational business (regardless of whether the entity is a US or foreign person) makes a withholdable payment. From a practical perspective, a large range of payors can be impacted – just about any multinational business that makes payments falling within this definition will experience the impact of FATCA. As a result, global organizations should focus their efforts on payment details such as:

- which legal entity or department is authorizing the payment
- which legal entity or department is making the payment
- the recipient of the payment
- source (and US federal income tax sourcing) of the payment
- the character of the payment.

Expansive definition of a withholdable payment

The term withholdable payment generally refers to the gross amount of US source FDAP income, and can include other types of US source income not otherwise subject to withholding

under Chapter 3. For example, gross proceeds from the sale of certain property are included in the definition.

Treasury functions, accounts payable departments, and other areas of a global organization may make many withholdable payments. The following are a few common examples of third-party or intercompany payments that may be included in the definition:

- interest and dividends
- bank and custodial fees
- advisory and broker fees associated with merger and acquisition activity
- insurance or reinsurance premiums paid for insuring US risk
- gross proceeds from derivatives, swaps, and other hedging arrangements, typically performed by the treasury function.

Certain payments made in the ordinary course of business are not treated as withholdable payments under FATCA. However, some of these payments (such as payments for services, rents, and royalties) remain subject to existing information reporting and withholding requirements. Certain obligations in existence

on January 1, 2014 are considered 'grandfathered' and are not subject to FATCA withholding. One of the challenges for businesses will be updating systems and processes to distinguish between all of these types of payments.

Obligation to identify payees and remit tax

As a core concept, payors of a withholdable payment must ask, "Who is the payee?" and "Are they FATCA compliant?" Government forms currently relied upon to document payees are being modified to accommodate FATCA. Importantly, the FATCA regime also requires withholding agents to commence 30% FATCA withholding on withholdable payments beginning on January 1, 2014 (with withholding on gross proceeds beginning in 2017).

Payors will need to use the new documents to ensure that their counterparties are FATCA compliant or exempt from withholding. For example, if the withholding agent receives sufficient documentation, such as a global intermediary identification number (GIIN) from an FFI or a valid Form W-8, withholding is not required (although reporting must still be completed).

Key takeaway:

The final regulations mandate that beginning on January 1, 2014, payors of withholdable payments must have processes and procedures in place to identify and categorize non-US payees under these new rules and report such payments for FATCA purposes. Will your internal resources be ready to implement these new obligations along with the expanded withholding requirements?

3. Your company is receiving US source payments (you're the payee)

Those entities within your group receiving withholdable payments may be subject to 30% FATCA withholding. You may be surprised that various types of entities may be at risk. These may include a nonfinancial entity located outside of the United States, which may be treated as an NFFE and subject to FATCA withholding if it fails to timely and properly identify itself to its withholding agent.

Moreover, an entity that qualifies as an FFI will also be subject to FATCA withholding if it fails to provide valid documentation or present a GIIN to prove that it is compliant (participating) with the FATCA rules. As an example, treasury centers must evaluate whether they are classified as FFIs to ensure that appropriate documents can be provided to requesting banks and other payors.

Key takeaway:

The bottom line is that all foreign entities receiving withholdable payments must substantiate their status for FATCA purposes. As they begin to receive payments from withholding agents and FFIs around the globe, they will be asked to provide documentation about their non-US status and certify their FATCA classification.

The cost of noncompliance

Businesses that do not adhere to the new obligations under FATCA may face a variety of consequences. The possible loss of 30% of the value of specific payments is of foremost concern. Consistent with other US information reporting regimes, a payor who fails to deduct and remit FATCA withholding when required will be liable for **100% of the amount not withheld as well as related interest and penalties**. Depending upon the contractual arrangement between the parties, these amounts may or may not be recoverable.

Potentially negative consequences with respect to **financial statements** also may occur. Financial accounting rules (i.e., FAS 5) may require the establishment of reserves for

contingent tax liabilities if there is a risk of assessment by a tax authority. This potential drag on financial statement earnings generally depends upon the likelihood (probability) of the success of such assessment.

A payee within the group that **receives a payment that is less than expected** due to FATCA withholding will be problematic. As an example, investment returns on alternative investment could be reduced by 30% if the investment fund is subject to FATCA withholding. Consequently, organizations should ensure they have communicated with their counterparties both to provide proper documentation and determine if the counterparty intends to be FATCA compliant.

Wasted time and resources also may occur if policies and procedures are inadequate to address the documentation, reporting, and withholding obligations. Accounts payable departments and treasury centers (among other departments) may already be requesting and maintaining tax documentation from parties receiving payments. However, there are new forms that will be used, new requirements, and new types of information (such as GIINs) that must be requested. As a result, payment delays and potentially business delays may also occur.

Fast approaching deadlines

FATCA compliance is a present challenge, and multinational firms should begin to define what is and what is not required as soon as possible. The final regulations and IGAs contain many different one time deadlines as well as due dates that will repeat on a periodic basis. Most notably, beginning January 1, 2014, payors of withholdable payments must have processes

and procedures in place to identify and categorize non-US payees for purposes of FATCA, report such payments, and potentially withhold 30% tax.

In addition, prior to January 1, 2014, foreign legal entities with FFI characteristics must determine whether they are, in fact, FFIs and should register with the IRS. Registration begins no later

than July 15, 2013, and those completed by October 25, 2013 will be on the first IRS published GIIN list – to be released in December. Once registered, FFIs must certify in 2015 that they were compliant with FATCA obligations as of January 1, 2014.

Assessing the inevitable impact and building a tailored action plan

So, what are some practical steps that multinational businesses can take in order to establish FATCA compliance and avoid unnecessary withholding and other adverse consequences? A simple approach is first to assess its impact to the organization – pinpoint where FATCA withholding may occur, as well as processes that should be in place to achieve compliance and minimize costs. This approach may involve the following actions:

Categorize foreign entities

Although inventorying and categorizing FFIs appears to be a task targeted at the financial services industry, nonfinancial businesses will find themselves having to identify their legal entities correctly. Given the broad definition of an FFI, companies should think about the specific types of entities described above that generally trigger a concern. Multinational corporations should still examine their remaining entities to ensure that they do not meet the definition of an FFI.

Scrutinize global payment flows

Companies first should examine their payee and counterparty base with a focus on foreign parties. Because of FATCA, global organizations need to know where they make and receive payments around the world. What are the payments for and who are they received by? What payment flows within the United States and globally may involve withholdable payments? How are these payments sourced for US federal income tax purposes? What legal entities or departments are authorizing and making the payments?

Educate business stakeholders

How will resulting processes affect business flows and contracts? Testing the new processes before they go live may be an important step to identifying problems upfront, helping to increase efficiency. Do existing and future business contracts need to be modified?

Determine who is involved in the process and who should be trained

Given the liability around withholding and in some cases needing to certify compliance, having the appropriate input from leadership is critical. Moreover, many of the processes relating to FATCA occur throughout the organization and therefore having a robust training and education strategy is an important task.

Examine related processes

Multinational businesses should examine existing processes used to identify payees and documentation currently collected on certain payments to foreign persons under Chapters 3 and 61, as compared to the rules under FATCA. What procedures need to change or be added? How will documentation be stored and shared among all parties within the organization that may need it? New revised Forms W-8 and the introduction of GIINs will also need to be taken into account.

Let's talk



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For a list of FATCA specialists by country, [click here](#).

Additional background

For additional information regarding FATCA guidance and implementation, please [click here](#) for the Global IRW Newsbrief archive.

How do you plan to keep up-to-date with the release of the FATCA IGAs and some of their unique differences? ***Access our FATCA IGA Monitor*** website that includes:

- a high-level overview of signed IGAs
- the latest IGA developments
- potential actions to think about as you look at the impact of the IGAs to your FATCA program.

For a link to the US Treasury FATCA Resource Center, [click here](#).

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