
United States: How do the latest information reporting requirements impact your nonfinancial multinational company? (Part 1)

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In brief

The requirements of the Foreign Account Tax Compliance Act (FATCA) and other recently issued US information reporting regulations are either effective immediately or are set to apply beginning on July 1. These rules not only impact the financial services sector, but are expected to affect many nonfinancial services entities with operations both in and outside of the United States. Unfortunately, many nonfinancial multinational companies (MNCs) believe the two sets of recently released final and temporary regulations do not affect them. Moreover, MNCs believe that they do not need to take any action to be compliant with FATCA or to accommodate the overall changes to existing information reporting and withholding processes and procedures.

Nonfinancial MNCs that were in compliance with existing tax reporting and withholding requirements are discovering they have many new responsibilities and requirements as a result of the modifications to the regulations. These regulations not only impact payment flows; they also impact payee documentation requirements and the associated presumption rules when documentation is not provided. Moreover, nonfinancial MNCs are discovering that foreign financial institutions (FFIs) exist in their group despite FATCA providing many exceptions and special carve outs that limit which entities are considered to be financial institutions.

This is the first of two *Tax Insights* describing some significant regulatory items impacting nonfinancial MNCs. The topics addressed in this article include:

- *Entities classified as FFIs* – The new FATCA regulations contain a number of changes that affect the definition of holding companies, treasury centers, and excepted nonfinancial group entities.
 - *Classifying nonfinancial foreign entities (NFFE)* – The requirements for determining if an entity is an active NFFE have been clarified.
 - *Alignment of withholding requirements* – The new regulations eliminate instances when a withholding agent could be required to withhold more than 30% under a combination of FATCA, Chapter 3, and Section 3406 of the Internal Revenue Code.
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- **Revised reporting obligations -**
The new FATCA regulations attempt to streamline the reporting requirements by merging some requirements and providing special rules on how reporting should occur.

The next *Tax Insights* will examine changes to the documentation requirements and the application of the presumption rules. Please also see an earlier PwC *Insight* released on February 28, 2014 which highlighted many of the updates provided in these final and temporary regulations for all industries.

In detail

How the new regulations change the information reporting landscape

The new regulatory guidance is a compilation of many distinct amendments, clarifications, and attempts to harmonize the requirements of FATCA with existing US reporting and withholding requirements. While core concepts of FATCA are unchanged, the latest rules clarify what obligations an FFI must satisfy, including registering and entering into an FFI agreement with the IRS, documentation, withholding, and reporting. Similarly the core concepts under Chapters 3 and 61 and Section 3406 remain unchanged; however, the new regulatory guidance attempts to coordinate FATCA requirements and avoid duplicative documentation, withholding, and reporting.

The US Department of the Treasury (Treasury) stated in a [press release](#) issued simultaneously with the revised guidance that the regulations should be the last substantial guidance necessary to implement FATCA. However, it is anticipated that Treasury and the IRS will still issue technical corrections, updated

agreements for qualified intermediaries, withholding for foreign partnerships and trusts, and final forms and instructions.

Classification of entities

Entities classified as FFIs

Determining the FATCA status of each entity in a group of companies is the first step in evaluating the FATCA-related obligations of the group and each company within the group. The new regulations provide clarification about the types of entities that are classified as FFIs. Entities that are classified as FFIs may be required to register with the IRS and satisfy specific requirements pertaining to due diligence, documentation, withholding, and reporting.

The nonfinancial group test

Holding companies and treasury centers can avoid FFI status if they are members of an expanded affiliated group (EAG) that is a 'nonfinancial group.' Nonfinancial group status is obtained by satisfying certain asset and income tests.

The temporary regulations clarify that the income and asset tests must be met in each of the three years prior to the year of testing – and not the average of the years. Under the temporary regulations, an EAG that has been in existence for less than three years meets the test if, in each year of its existence, it satisfies the tests.

Observation: *A number of nonfinancial sector companies may struggle to meet the 'each year' requirement of this test, especially if there was a significant disposition or acquisition within the three year testing period. Additionally, an EAG can toggle in and out of nonfinancial group status each year. This could result in an entity's FATCA status varying from year to year.*

Moreover, a number of holding companies and treasury centers can also meet the other definitions of FFI status, which can make this determination even more difficult.

Holding companies classified as FFIs

The temporary regulations expand the types of entities that can qualify as a holding company FFI. Partnerships or other noncorporate entities that own stock in one or more members of an EAG are permitted (but not required) to be treated as holding companies and could qualify as excepted nonfinancial group entities.

Observation: *At the election of the taxpayer, a noncorporate entity can be treated as the common parent of an EAG. This election permits a group of companies to have either a single combined EAG or multiple smaller EAGs each led by corporate common parent entities. Ultimately a group that is led by a noncorporate entity can test the larger group or each of the smaller groups for nonfinancial group status. This provides flexibility for organizations to meet the nonfinancial group test.*

Broadened definition of treasury center

Under the final FATCA regulations, a group's cash pooling entity would have been ineligible for treasury center treatment if it was in a deficit position. The temporary regulations clarify that an entity that manages the working capital of one or more EAG members will not cease to qualify as a treasury center solely because it has no investments and does not trade in financial assets. The temporary regulations also state that equity-funded affiliates may also qualify as treasury centers.

Treasury centers that enter into investment, hedging, and financing transactions with or for members of

an EAG for various purposes can also benefit under the exceptions for nonfinancial groups.

Observation: *These clarifications were welcomed by industry and were necessary to cover a large number of cash pooling entities that would not otherwise have met the definition of a treasury center in a nonfinancial group.*

Grandfathered rule for excepted nonfinancial group entities

Holding companies, treasury centers, and captive finance companies are generally treated as FFIs under the final regulations if they are formed or availed of by a fund or other collective investment vehicle (like a private equity or venture capital fund). The temporary regulations clarify that such an entity can be an excepted nonfinancial group entity and consequently not considered formed in connection with or availed of by an investment vehicle if it existed six months prior to its acquisition and prior to its acquisition regularly conducted activities in the ordinary course of business.

Insurance companies treated as US persons

A non-US insurance company may qualify as an FFI if it is a specified insurance company. The temporary regulations expand the definition of 'US person' to include an insurance company organized outside the US that has elected to be classified as a US person under Section 953(d) of the Code, provided that it is not a specified insurance company and not licensed to do business in any of the United States or it is a specified insurance company and is licensed to do business in any state.

Observation: *Certain captive insurance companies may be able to utilize a Section 953(d) election if certain specified requirements are*

satisfied. This change enables greater symmetry between FATCA and income tax rules applicable to insurers.

Classifying nonfinancial foreign entities

A non-US entity that is not an FFI is generally viewed as an NFFE. NFFEs are potentially subject to 30% FATCA withholding on certain payments unless they provide appropriate documentation to the payor. FATCA withholding, however, is generally not required on payments to excepted NFFEs. The temporary regulations provide details about a new type of excepted NFFE – the direct reporting NFFE (announced in Notice 2013-69) and clarify existing definitions.

Testing for active NFFE status

An active NFFE is a type of excepted NFFE that meets certain passive income and asset thresholds. The final FATCA regulations contained a requirement that calendar year financial statements be used to conduct this analysis. Treasury expanded this rule in the temporary regulations, which now permit the use of financial statements prepared on either a calendar or fiscal year basis. The regulations also permit the use of financial statements prepared pursuant to both US (Generally Accepted Accounting Principles or GAAP) and non-US (i.e., International Financial Reporting Standards or IFRS) accounting principles.

Observation: *It appears that Treasury made this change because it recognized the burdens that could arise for companies that report on a fiscal year basis or that are based outside the US and apply IFRS and not GAAP principles for accounting purposes.*

Sponsored investment entities

It is expected that certain nonfinancial MNCs that are determined to be an

FFI will choose to be sponsored entities. The temporary regulations amend the definition of sponsored investment entity to clarify that a nonparticipating FFI (NPFFI, generally an FFI that does not properly register with the IRS) cannot act as a sponsoring entity. Sponsoring entities can be any entity that is authorized to act on behalf of an FFI and is either a US entity or any entity that is not a NPFFI. MNCs that elect to comply with FATCA by being a sponsored entity may be sponsored by a parent or affiliated entity. The sponsoring entity must be able to satisfy the FATCA requirements (i.e., reporting, withholding, etc.).

In addition, the regulations clarify more broadly that a sponsored FFI remains liable for its withholding and reporting obligations despite having a sponsoring entity that performs these tasks on its behalf. Accordingly, the sponsoring entity will not be jointly and severally liable for the sponsored FFI's obligations unless the sponsoring entity is also a withholding agent that is separately liable for such obligations.

Observation: *The use of sponsored investment entities can be helpful for a multinational group where certain group entities already control the financial operations of that entity. Sponsored entities do not need to register by May 5, 2014 (the date by which FFIs must register with the IRS to be included on the first IRS list of registered FFIs) but instead can use their sponsoring entity's global intermediary identification number (GIIN) through December 31, 2015. Further guidance is expected to describe how these entities will register.*

Changes to withholding requirements

Withholding agents and payors have a variety of existing obligations under Chapters 3 and 61 and Section 3406 of the Code to report and withhold tax.

FATCA imposes additional reporting and withholding requirements (i.e., 30% FATCA withholding, documentation, etc.) when a withholdable payment is made to persons subject to FATCA reporting and withholding (i.e., NPFFIs, recalcitrant account holders, etc.). The temporary FATCA and harmonization regulations insert an ordering rule to avoid excessive withholding when a withholding agent or payor could be required to withhold more than 30% under a combination of Chapters 3 and 4 and Section 3406 of the Code. Specifically, if 30% FATCA withholding is applied to a payment, it is viewed as a credit toward withholding that may also apply under Chapter 3 or Section 3406. This credit mechanism prevents withholding tax from exceeding 30%.

Other changes have been made, including those highlighted below:

Definition of grandfathered obligation

FATCA withholding does not apply to payments made with respect to grandfathered obligations. Under the temporary regulations, if a grandfathered obligation loses its grandfathered status due to a material modification, a withholding agent is required to withhold under FATCA if it has actual knowledge that the material modification occurred. The final regulations required withholding on grandfathered obligations that had a material modification if the withholding agent had 'reason to know.' A disclosure indicating that there has been or will be a material modification to the obligation is sufficient to establish actual knowledge.

Observation: *The changes made to the rules involving grandfathered obligations should reduce the risk of FATCA withholding tax liability for withholding agents that failed to impose FATCA withholding on*

grandfathered obligations that had a material modification.

Reportable payments made outside the US by foreign persons

The existing regulations include an exception from backup withholding for certain reportable payments made outside the US to payees other than known US persons and for payments made outside of the US in which documentary evidence instead of withholding certificates can be relied upon to identify the payee. The modification redefines reportable payments outside of the US as reportable payments that are paid and received outside the US with respect to an offshore obligation, including a sale that occurs outside the US.

Claim for credit or refund of Chapter 4 withholding

To the extent that a refund of taxes inadvertently withheld is not available from the withholding agent, the temporary regulations allow companies to claim a credit or refund of an overpayment under Chapter 4 for a taxpayer that attaches a copy of either Form 1042-S, Form 8805, or other statement to its income tax return. Contrary to general statements in the preamble, the regulations require a tax identification number (TIN) on the documentation. Note, preambles to regulations do not always specifically describe the regulatory requirement. It is important to read the regulation in addition to the preamble to understand the requirements.

Observation: *Under prior rules, a refund was allowed by the beneficial owner of a withholdable payment if certain conditions were met. However, it was not clear how to apply for such a refund.*

Revised reporting obligations

FATCA imposes reporting obligations for those entities affected by FATCA in

addition to the existing reporting requirements under Chapters 3 and 61. The temporary FATCA regulations attempt to streamline the new and existing requirements by merging some of them and also provide special rules on how reporting should occur given the specific procedural requirements and terminology under FATCA.

Observation: *The first FATCA reporting is not due until March 2015, but payment and payee data should be gathered starting July 1, 2014. The new regulations provide both transitional rules and permanent provisions to give taxpayers more time to prepare appropriately.*

Form 1042-S reporting for flow-through entities

The prior regulations required that excepted or passive NFFEs be treated as recipients of payments even if they were flow-through entities such as partnerships. This was inconsistent with the treatment of such entities under Chapter 3. To harmonize the treatment of these payments for Chapters 3 and 4, the new regulations modify the Chapter 4 treatment of these payments to provide that an excepted or passive NFFE that is a flow-through entity is not a recipient.

The temporary regulations also provide that a participating FFI (PFFI) or registered deemed-compliant FFI (RDCFFI) will not cease to be a recipient if it fails to provide a withholding agent with information regarding its reporting pools (which are reflected on Form 1042-S).

New exceptions for reporting interest and OID

The final regulations provide exceptions to Form 1099 (including MISC, INT, DIV, etc.) reporting in certain circumstances. The

regulations provide that Form 1099 reporting is not required for a non-US payor that is also a PFFI or RDCFFI that reports an account holder on Form 8966 or pursuant to an intergovernmental agreement (IGA), provided such information includes the account holder's TIN.

The regulations provide another exception from Form 1099 reporting for PFFIs and RDCFFIs regardless of whether they are a US or non-US payor. Under this exception, Form 1099 reporting is not required if the holder of an account maintained by the FFI receives a payment of interest and dividends that is not subject to withholding under Chapter 3 or under Section 3406 (i.e., backup withholding) and either the FFI reports the account under the rules for reporting recalcitrant account pools or in the case of a reporting Model 1 FFI, the account holder has not provided information sufficient for the FFI to confirm the US or non-US status of the account holder and the FFI treats and reports the account as a US reportable account under an applicable IGA.

Observation: *This provision makes collection of TINs even more important for multinationals that may need to make certain systemic modifications in order to capture this information.*

The takeaway

FATCA implementation dates are fast-approaching. Most importantly, FATCA withholding is effective for certain payments starting as early as July 1, 2014. FFIs have just a few days

until May 5, 2014 to finalize their registration and obtain a GIIN to be included on the first IRS list of registered FFIs. This GIIN should enable the FFI to more quickly establish its FATCA status to a payor, enabling more efficient payment flows.

Accordingly, time is of the essence to analyze the impact of the FATCA rules on your organization and comprise an overall compliance plan going forward. Companies should give FATCA compliance a greater priority to minimize payment delays and unexpected withholding costs relating to its status as either a payee or payor. Consider the following actions:

- A critical first step is to **categorize foreign entities** to determine their FATCA classification and any other corresponding actions or obligations. The definition of an FFI can be unexpectedly broad and MNCs should examine all of their entities, particularly those that generally trigger a concern, including holding companies, treasury centers, insurance-related entities, and pension plans. Several regulatory changes could alter the legal entity analysis so it is important to utilize the most current guidance.
- Nonfinancial MNCs should **scrutinize their global payment flows** to pinpoint where there could be obligations for entities to withhold tax under

either FATCA or other provisions. Questions to ask include:

- What flows could include withholdable payments? This would include both payments made from group entities to unrelated parties as well as intragroup payments.
- What multinational group entities may be receiving payments that could be subject to withholding? Are these entities prepared to provide their FATCA status if asked by the payor?

Several key points of clarification included in the new regulations will require companies to review existing policies and procedures that they have historically relied upon for domestic transactions, to modify systems to accommodate these changes, and to train and deploy resources as appropriate to implement any changes.

A core step to all of these preparatory actions is a thorough review of the recently released temporary and harmonization regulations. This is a task that may be more time consuming than expected due to the length of the regulations and the large number of provisions impacted. This recent guidance should be viewed as the last substantial guidance to implement FATCA. However, MNCs should also understand that there will likely be additional guidance released by the IRS in the future that should be analyzed for its impact on compliance plans.

Let's talk

For more information on how FATCA might impact your MNC, please contact a member of the PwC's Global Information Reporting Network. To view contacts for over 70 countries worldwide, click [here](#).

Additional information

To download the PwC formatted version of the updated FATCA regulations, please [click here](#).

For other information regarding FATCA guidance and implementation, please click [here](#) for the *Global Information Reporting* thought leadership archive.

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