

# ***United States: How do the latest information reporting requirements impact your nonfinancial multinational company? (Part 2)***

*June 2, 2014*

## ***In brief***

The requirements of the Foreign Account Tax Compliance Act (FATCA) and other recently revised 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 entities outside of the traditional financial services sector with operations both in and outside of the United States. Unfortunately, many nonfinancial multinational companies (nonfinancial MNCs) still mistakenly believe the two sets of final and temporary [regulations](#) released by the US Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) on February 20, 2014 will not affect them. Accordingly, they incorrectly believe that they do not need to take any action to address either FATCA or the corresponding changes to the US information reporting and withholding requirements as part of their overall compliance program.

A number of nonfinancial MNCs that were in compliance with existing information reporting and withholding requirements for payments to US and non-US payees are finding that they have a number of new or revised responsibilities and requirements because of the regulations that harmonize the existing information reporting and withholding obligations under Chapters 3 and 61 and Section 3406 of the Internal Revenue Code (Code) with FATCA. These harmonization regulations not only impact their payment flows, but affect the documentation they receive from payees and the presumption rules that apply with regard to payees who fail to provide valid documentation in a timely manner. Moreover, other nonfinancial MNCs are discovering that the exceptions to what constitutes a foreign financial institution (FFI), which was further clarified under the recently released regulations, may not be as beneficial as they thought they would be. As a result, they are finding that FFIs may exist in their MNC groups.

Fortunately, the Treasury and IRS recently announced that calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration with respect to the implementation of FATCA and these fairly complex regulations. This relief means that the IRS will take into account the extent to which withholding agents, FFIs, and other entities are making a good faith effort to comply with the requirements and the modifications to existing information reporting and withholding obligations until calendar year 2016. For example, the IRS will take into account

whether a withholding agent has made reasonable efforts during the transition period to modify its account opening practices and procedures to document the Chapter 4 status of payees, apply the standards of knowledge provided in Chapter 4, and, in the absence of reliable documentation, apply the presumption rules. See our [Tax Insight](#) on the good faith transitional relief.

This is the latest in our series of *Tax Insights* describing some of the significant items in the regulations impacting nonfinancial MNCs. The topics addressed in this insight include:

- *Documentation needed to classify payees* - Rules have been updated relating to the expiration of Forms W-8, validity of facsimile or emailed forms, and coordination of documentation standards under FATCA with Chapters 3 and 61 and Section 3406 of the Code.
- *Presumption rules used when payees do not provide sufficient documentation* - The presumption rules under existing Chapters 3 and 61 of the Code have been modified to reflect the requirements of FATCA.

An earlier [Tax Insight](#) examined entities classified as FFIs, classification of nonfinancial foreign entities (NFFEs), the responsibilities of sponsored entities, the alignment of withholding requirements, and revised reporting obligations. Please also see another earlier [Tax Insight](#) which highlighted many of the updates provided in these final and temporary regulations affecting all industries.

## In detail

### **Documentation needed to classify payees**

One of the most significant responsibilities imposed on a MNC in the US information reporting and withholding framework is the requirement to identify payees by collecting and reviewing documentation in order to reduce or eliminate withholding tax when certain payments are made to US and non-US payees. MNCs are accustomed to collecting Forms W-8 (most often the Form W-8BEN) when they make payments of US source fixed or determinable annual or periodic (FDAP) income to non-US parties, such as vendors or investors. This process enables the foreign payee to certify itself as non-US and document its eligibility for a lower rate of withholding and, consequently, be able to receive FDAP payments free from withholding or subject to a reduced rate of withholding. The same Form W-8 documentation will also provide a basis for classifying payees for FATCA purposes. Changes have been made not only to the Forms W-8, but also to the rules governing what information is required on these forms, as well as how and when they are to be used.

These changes include, but are not limited to, the following:

### *Indefinite validity of Forms W-8 now limited*

The final FATCA regulations provided that, under certain circumstances, withholding certificates could remain valid indefinitely or until there is a change in circumstances. However, the new harmonization regulations specify that indefinite validity does not apply to the portion of the withholding certificate that pertains to a claim for treaty benefits to reduce withholding under Chapter 3.

**Observation:** The loss of indefinite validity for a claim of income tax treaty benefits significantly diminishes the value of indefinite validity of Forms W-8 collected by a nonfinancial MNC. This is the case because many of the payments made by an accounts payable (AP) or treasury function require a valid treaty claim to reduce the rate of withholding.

### *Transitional relief for expiring Forms W-8*

In Notice 2013-43, the IRS extended the validity period of Forms W-8 and documentary evidence that were set to expire on December 31, 2013 to June 30, 2014. The temporary regulations provide additional transitional relief by extending the validity period of such forms to December 31, 2014. The relief is provided in anticipation of the IRS releasing revised Forms W-8 containing changes needed to implement FATCA. The extension of the validity period for Forms W-8 and documentary evidence permits withholding agents to obtain pre-FATCA Forms W-8 while the IRS continues its efforts to release new forms and instructions containing information relevant to a payee's FATCA status. The extended validity period and the six month period that withholding agents are allowed before use of the new Forms W-8 become mandatory are intended to give withholding agents time to incorporate the new documentation requirements over time.

**Observation:** The additional six months of validity plus the recently announced extension of time to document entity payees under Notice 2014-33 provide welcome relief to withholding agents faced with a compressed time-frame in which to obtain new and valid forms from payees before applying the presumption rules. Further, this

timeframe is more in line with practices for annual solicitations from payees for new Forms W-8 in advance of their expiration.

#### *Faxed and emailed forms*

Forms W-8 historically were valid only if they were collected as original (i.e., ink-on-paper) documents. Forms obtained by facsimile or through email attachments were not considered valid (except in very limited circumstances). For forms collected on or after July 1, 2014, the temporary regulations relax the requirement to obtain an original form. Faxed and emailed forms that are otherwise valid will not be invalidated simply because they were received by fax or email. Withholding agents collecting such forms must, however, invalidate the form if they have actual knowledge that the person transmitting the form was not authorized to do so by the person required to execute the form.

**Observation:** *By allowing withholding agents to rely on forms received via fax or email, the IRS is removing a significant compliance challenge and trap for the unwary. Prior to this change, withholding agents encountered challenges obtaining original signed forms in a timely manner. Withholding agents should be sure to implement procedures to comply with these requirements.*

#### *Chapter 4 status required on Form W-8*

The new Form W-8 enables a beneficial owner to indicate its FATCA status as well as to provide information required for Chapter 3 purposes. The regulations provide that the new Form W-8 must include the Chapter 4 status of a beneficial owner in order to be valid when a beneficial owner is receiving a withholdable payment. This implies that the form will not need to reflect

the beneficial owner's FATCA status if a withholdable payment is not made.

**Observation:** *The ability of AP departments to obtain Forms W-8 without the added complexity of obtaining the FATCA status is a benefit since the majority of payments typically made by AP departments may not be withholdable payments due to a carve-out for excluded nonfinancial payments. However, procedures are needed to make certain a FATCA status is obtained from payees who receive withholdable payments such as bank fees. While this flexibility offers opportunity for simplification, multiple procedures also add complexity to an AP department's operations.*

#### *Foreign TINs to claim treaty benefits*

Certain payments of US FDAP income are eligible for a reduced rate of withholding under Chapter 3 if the beneficial owner of the income makes a valid claim for a reduced rate of withholding pursuant to an income tax treaty on a Form W-8BEN or W-8BEN-E (when the latter is finalized). Beneficial owners making a valid treaty claim on a Form W-8BEN or W-8BEN-E generally must provide their US taxpayer identification number (TIN). Under the new harmonization regulations, the requirement to furnish a US TIN has been replaced with a requirement to furnish either a US TIN or a non-US TIN issued by the beneficial owner's country of residence. However, for entities in countries that do not issue a foreign TIN, a US TIN generally will still be required.

**Observation:** *The IRS and Treasury believe a non-US TIN is "an effective alternative to a US TIN" in supporting a claim for treaty benefits. The ability to use a foreign TIN to claim treaty benefits is a welcome change for many AP departments. At the same time, this*

*option necessitates a change to exiting technology used to manage vendor data to accommodate the collection of a non-US TIN. Collecting a non-US TIN presents an additional challenge because there is no universal source that describes the composition of all non-US TINs.*

#### *Additional requirement for EIN if effectively connected income*

A withholding agent may presume that US source FDAP income payments made to a US branch of a regulated foreign bank or insurance company is income effectively connected (ECI) with a US trade or business without having to obtain a Form W-8. The revised Chapter 3 harmonization regulations require a withholding agent to obtain the US branch's employer identification number (EIN) to rely on the presumption that the payment is ECI.

#### *Treatment of US insurance brokers*

A payment made to a US agent of a non-US person that is subject to FATCA or Chapter 3 reporting and withholding is presumed to be paid to an undocumented non-US person in the absence of documentation. There is an exception if the US agent is a US financial institution; in that case, the payment is deemed paid to the US financial institution unless the withholding agent knows that the US financial institution will not comply with its information reporting and withholding obligations.

The harmonization regulations expand this rule when insurance premiums are paid to a US insurance broker acting as agent for a foreign insurance company. Under the regulations, a withholding agent can treat the US insurance broker, rather than the underlying foreign insurer, as a payee when it receives insurance premiums on behalf of a foreign insurance company as long as the withholding agent does not have

reason to know that the US insurance broker will not satisfy its reporting and withholding obligations. The temporary regulations also include many changes that are specifically relevant to insurance companies. See our previously published *Tax Insight* on how the new regulations impact insurers.

**Observation:** *Insurance premiums paid to global brokers still need to be evaluated to determine if they relate to US risk.*

*Form W-8 obtained more than a year after payment*

In general, a withholding agent that cannot reliably associate a payment with valid documentation on the payment date, and fails to withhold tax as required, is liable for any amount of tax that should have been withheld. Proof that a reduced rate of withholding was, in fact, appropriate, however, may be established after the payment date on the basis of a valid withholding certificate furnished after that date. Under the regulations, withholding agents are permitted to obtain withholding certificates more than a year after the payment date under certain conditions. In order for withholding agents to obtain this relief, the regulations require that the withholding agent also obtain certain documentary evidence in addition to an affidavit indicating that the information and representations contained on the withholding certificate were accurate as of the time of the payment.

**Observation:** *Although this procedure may be useful for limiting a withholding agent's liability for under-withholding, a withholding agent will remain liable if it cannot obtain the necessary documentation to establish that a reduced rate of withholding was appropriate. Moreover, since no similar provision applies to a payment to a US person,*

*the appropriate document needs to be in hand when the payment is made.*

*Coordination with Chapter 61*

Regulations under Chapter 61 (relating to information returns – e.g., Forms 1099) require payors to determine the identity of recipients based on documentation requirements similar to Chapter 3. The new regulations describe the circumstances when documentary evidence (such as certificates of residency and other documentation) can be relied upon. The new regulations allow payors, in certain circumstances, to rely on documentary evidence to establish that the payee is a non-US person and consequently not subject to reporting or withholding under Chapter 61 and Section 3406.

**Observation:** *These changes are intended to achieve consistency with the new FATCA provisions under Chapter 4.*

*Pre-existing obligations owned by US persons - 'Eyeball test'*

The final FATCA regulations allowed a withholding agent to treat a payee as a US person for pre-existing obligations if the withholding agent had previously reviewed a Form W-9 or other documentation that established the payee's status as a US person that was an exempt recipient under Chapter 61. The temporary regulations relax this requirement and permit the withholding agent to treat the payee as a US person if the withholding agent had previously classified the person as a US person that is an exempt recipient under the provisions of Chapter 3 or Chapter 61. This change includes classification under the 'eyeball test' in the absence of a withholding certificate.

**Presumption rules used if no documentation**

In the absence of documentation, withholding agents (which includes controlled foreign corporations of US entities that are US payors under these rules) are required to rely on 'presumption rules' to determine the status of a payee (e.g., as an individual, partnership, corporation, etc.) as well as the payee's status as a US or non-US person. The regulations attempt to simplify the process of applying the presumption rules by coordinating their application for purposes of both Chapters 3 and 4.

Some of the changes made to achieve this linkage include the following:

*Presumption for US non-exempt recipients*

The temporary regulations add a presumption rule for offshore obligations. The new rule presumes an individual to be a non-US person unless there are US indicia associated with the payee. The old presumption rule presumed an individual to be a US person with limited exceptions.

**Observation:** *Payments to undocumented individuals have historically been treated as payments to a US person subject to backup withholding. Requiring that a payee have an indicator of US status for an offshore obligation may reduce the incidence of inappropriate reporting and backup withholding.*

*Undocumented exempt recipients*

An undocumented exempt recipient is generally presumed to be a US person, unless the withholding agent has one or more specified types of indicia of foreign status, in which case an exempt recipient will be presumed to be a non-US person. The temporary regulations modify these indicia to better align with the FATCA regulations and added a fifth

indicator: a telephone number outside the US.

The new harmonization regulations also provide that names containing 'corporation' or 'company' are not indications that the payee is an entity included on the list of *per se* foreign corporations for purposes of treating the entity as a non-US person.

#### *Special rule for withholdable payments made to certain exempt recipients*

Certain undocumented payees that are presumed to be exempt recipients will be presumed to be nonparticipating FFIs (NPFFIs) for purposes of FATCA. The exempt recipients that are treated as NPFFIs are as follows:

- corporations with an indication of corporation or insurance in their name
- foreign governments
- international organizations
- foreign central bank of issue
- financial institutions
- nominees or custodians
- brokers
- swap dealers

Under the new regulations, this special presumption rule for exempt recipients is now limited to the following circumstances:

- It applies only to withholdable payments under FATCA. However,

withholding agents may elect to apply the special presumption rule to payments other than withholdable payments.

- It does not apply to payments made to a payee of a pre-existing obligation for which the withholding agent determined prior to July 1, 2014 that the payee was a US exempt recipient.

**Observation:** *This rule is a significant departure from the presumption rule contained in prior FATCA regulations which would have forced undocumented exempt recipients into foreign status without regard to whether a payment was a withholdable payment or made with respect to a pre-existing obligation. This change may help mitigate adverse impacts (e.g., excessive withholding) for these undocumented payees.*

#### **The takeaway**

Given that many of the FATCA provisions are set to apply as early as July 1, time is of the essence to analyze the impact of the FATCA rules on your organization and comprise an overall compliance plan going forward. Each company 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.

Entities should also **examine existing processes** used to identify payees and documentation currently

collected with respect to certain payments under Chapters 3 and 61.

- What procedures need to be changed or added due to the overlay of the FATCA rules?
- Have the revised Forms W-8 and the introduction of global intermediary identification numbers (GIINs) been considered?

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