
FATCA's potential impact on global industrial products and services companies

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In brief

Beginning July 1, 2014, the Foreign Account Tax Compliance Act (FATCA) introduces significant new documentation, information reporting, and tax withholding requirements on certain entities making cross-border payments. Because FATCA is directed primarily at financial institutions, many companies whose primary business activities lie outside the traditional financial services arena mistakenly believe that they are not affected by the new regime. However, because FATCA's statutory language is broadly written, the new regime applies to a wide range of companies across all industries, including industrial products and services companies.

To ensure compliance with its requirements, FATCA imposes a 30% withholding tax on certain 'withholdable payments' made by and to certain non-US entities. Failure to comply with FATCA's requirements may impact companies as both payor and payee. Accordingly, companies should determine whether they have entities or operational areas within their global corporate structures that make or receive withholdable payments subject to FATCA's new requirements. Upon determining exactly how FATCA applies to their organizations, multinational industrial products and services companies should develop an action plan to implement processes and procedures to comply with the new requirements.

In detail

Background

FATCA was introduced in Congress in October 2009 as a comprehensive proposal to clamp down on US tax evasion and improve taxpayer compliance by providing the Internal Revenue Service (IRS) with new administrative tools to detect and deter offshore tax evasion. Enacted in March 2010, FATCA added chapter 4

to the Internal Revenue Code (Code). Chapter 4 expands -- and applies in addition to -- the existing information reporting and tax withholding rules for withholding agents and payors set forth in chapters 3, 24, and 61 of the Code.

FATCA's statutory provisions are intentionally broad and gave considerable discretion to the US Department of the Treasury (Treasury) and the IRS to narrow their application to

situations where a particular payment or entity poses a low risk of US tax evasion. In January 2013, Treasury and the IRS issued final regulations which addressed many of the concerns raised by stakeholders following the February 2012 release of the proposed regulations. See [Global IRW Newsbrief: Final FATCA regulations issued: Let the compliance begin.](#)

In July 2013, the IRS and Treasury announced revised timelines for implementing various FATCA provisions delaying many of the deadlines to July 1, 2014. See [*Global IRW Newsbrief: US government announces six-month extension to FATCA effective dates.*](#)

FATCA's application to FFIs

Beginning July 1, 2014, FATCA imposes new registration, due diligence, information reporting, and tax withholding obligations on entities that qualify as foreign financial institutions (FFIs). Because the definition of an FFI is broad, it applies to a wide range of companies across all industries. As a result, many industrial products and services companies may be unaware that certain entities within their global corporate structures may qualify as FFIs – meaning that they may have more information reporting and tax withholding obligations under FATCA than other types of withholding agents.

Entities that qualify as FFIs

Although the FATCA rules provide various exceptions, the following are types of entities within the corporate structures of many multinational companies that may qualify as FFIs:

- Non-US retirement funds and foundations 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 entity FFIs. Because vehicles for retirement savings are generally viewed as presenting a low risk of use for tax evasion, the regulations provide significant relief from FATCA's application to many retirement fund structures.

- Treasury centers, holding companies, and captive finance companies are also defined as FFIs. However, certain holding companies, treasury centers, and captive finance companies that are not part of a financial group are specifically excluded from FATCA if they primarily perform their activities for other members of their group. The activities relevant in assessing whether these types of entities are treated as FFIs include:

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

- Although special-purpose entities and banking-type subsidiaries are frequently used to access lower cost 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 definition of an FFI.
- Certain non-US insurance companies are FFIs. Captive insurance companies will qualify as FFIs if they have obligations to pay or issue cash value or annuity contracts. Even if a captive insurance company does not have such obligations, it should evaluate

its business operations to determine if it falls within another category of FFIs, including depository institutions, custodial institutions, investment entities, and certain holding companies and treasury centers.

Accordingly, the business lines, operations, and capital organization of each entity within the global corporate structure of an industrial products and services company should be reviewed and documented to determine its FATCA classification and whether it qualifies for an exception to being classified as an FFI.

Requirements under an FFI agreement

FATCA requires FFIs to register with the IRS, obtain a global intermediary identification number (GIIN), and enter into an FFI Agreement with the IRS to become participating FFIs (PFFIs). FFIs that do not qualify as exempt or deemed-compliant and do not enter into an FFI Agreement with the IRS are nonparticipating FFIs (NPFFIs).

The new FATCA online system for FFIs to register with the IRS opened on August 19, 2013. In addition to registering FFIs and providing them with a GIIN, the new system is intended to be used as a communication system between FFIs and the IRS. See [*Global IRW Newsbrief: IRS opens FATCA online registration system to provide a beneficial user testing period.*](#)

Beginning July 1, 2014, FFIs are required to perform due diligence on account holders, report certain financial account relations and transactions to the IRS, and withhold 30% tax on withholdable payments made to recalcitrant account holders and NPFFIs. Withholdable payments include certain US-source fixed or

determinable annual or periodic (FDAP) income, such as interest and dividends, and gross proceeds from the sale of US securities that could generate US-source FDAP income. Failure to withhold will cause FFIs to be liable for 100% of the tax that should have been withheld plus related penalties and interest.

FATCA's application to payors

FATCA generally applies when payors make withholdable payments to certain non-US payees. From a practical perspective, just about any multinational industrial products and services company that makes withholdable payments will qualify as a payor for FATCA purposes. As a result, these companies should focus on payment details such as:

- which legal entity or department is authorizing and/or making the payment
- who is receiving the payment
- what is the character of the payment
- what is the US income tax source of the payment.

Beginning July 1, 2014, FATCA requires payors to collect documentation sufficient to identify and categorize FFIs as either compliant or noncompliant with FATCA and report this and other information regarding these payees to the IRS. Failure to collect such documentation could require payors to impose a 30% withholding tax on certain withholdable payments. Failure to withhold will cause payors to be liable for 100% of the tax that should have been withheld plus related penalties and interest.

Also beginning July 1, 2014, FATCA requires withholding agents to withhold 30% tax on withholdable payments made to certain nonfinancial foreign entities (NFFEs)

that fail to provide information regarding their substantial US owners. NFFEs that have no substantial US owners or identify these owners to their withholding agents should not suffer the 30% FATCA withholding. Likewise, NFFEs that are deemed to represent a low risk of US tax evasion, such as nonfinancial publically traded companies and their affiliates, and those engaged in nonfinancial active trades or businesses, should not be subject to withholding.

In addition, certain non-US entities such as non-registering local banks, certain retirement plans, FFIs with only low-dollar accounts, nonprofit organizations, foreign governments, international organizations, foreign central banks, and governments of US possessions are exempted from FATCA if they are deemed to pose a low risk of being used to evade us tax. However, they should still be documented.

FATCA's application to payees

If a foreign affiliate is receiving a withholdable payment after July 1, 2014, it must substantiate its FATCA status to certain non-US payees or potentially face withholding. For example, a nonfinancial entity located outside of the United States, may be subject to FATCA withholding if it fails to timely and properly identify itself as an NFFE to any party that is making a withholdable payment to it. Likewise, an entity that qualifies as an FFI may also be subject to withholding if it fails to provide valid documentation to prove that it is FATCA compliant.

Expansive definition of withholdable payment

Withholdable payments may include:

- payments (including guaranteed payments) made in connection with a lending transaction

- payments made in connection with a forward, futures, or notional principal contract, or similar financial instrument
- premiums for insurance, reinsurance, or annuity contracts
- dividends, including dividends to foreign parents
- certain types of interest (including intercompany or third-party interest)
- investment advisory and brokerage fees (including associated with merger and acquisition activities)
- bank and custodial fees
- payments made with respect to various other transactions originating from the treasury function of an organization.

Generally, other payments made in the ordinary course of business are excluded from the definition of withholdable payments. For example, payments for services, compensation (including stock options), the use of property, office and equipment leases, software licenses, and interest on accounts payable from the acquisition of goods and services are generally excluded from the definition of a withholdable payment. In addition, payments made with respect to certain obligations in existence on July 1, 2014 such as debt obligations are considered 'grandfathered' and are not withholdable payments.

Intergovernmental agreements

The issuance of the final regulations followed the negotiations of several intergovernmental agreements (IGAs) between the Treasury and various foreign governments to mitigate certain foreign legal impediments to FATCA compliance. Under most of the IGAs signed to date, information will be exchanged directly between local governments and the IRS. This

requires entities in IGA jurisdictions to report information to their governments that may not have been required or permitted in the past.

Developing an action plan

Compliance with FATCA may require the revaluation and refinement of existing information reporting and tax withholding policies and procedures and changes to existing systems and controls. See [*Taking control of FATCA: Building effective internal controls and processes to promote compliance and certification.*](#)

Accordingly, multinational industrial products and services companies should assess FATCA's potential impact as part of a customized action plan. Critical steps of such a plan may include:

Categorizing foreign entities - Given the broad definition of an FFI, multinational industrial products and services companies should determine the FACTA classification of entities within their organizations.

Scrutinizing global payment flows - Multinational industrial products and services companies should examine their payee and counterparty base with a focus on foreign parties. They need to know where and for what reasons they make and receive payments around the world. They also should know whether these payments involve withholdable payments and which entities are authorizing and making these payments.

Examining related processes - Multinational industrial products and services companies should examine

existing processes used to identify and document payees for purposes of complying with current information reporting and withholding requirements under chapters 3 and 61 as compared to the FATCA rules under chapter 4.

Evaluating the use of technology - An effective process implemented by multinational industrial products and services companies may involve the introduction of technology to gain efficiencies and to leverage knowledge among related entities.

Determining who should be involved

- In determining who should be involved, multinational industrial products and services companies should consider that many of the processes relating to FATCA occur throughout the organization. Accordingly, changes to existing processes may affect multiple teams across many geographies and business units.

Training stakeholders - In training stakeholders, multinational industrial products and services companies should consider that a robust training and education program is critical to educate business teams, as well as those persons who will be handling the process going forward.

Documenting every step - As a critical part of the FATCA implementation process, multinational industrial products and services companies should document FATCA's impact on business units, controls, policies, procedures, and systems. Such documentation will be essential for managing future IRS examinations of FATCA compliance.

The takeaway

Industrial products and services companies that fail to adhere to FATCA's new requirements may face a variety of consequences, including the possible loss of 30% of certain withholdable payments. In addition, a payor that fails to withhold the 30% tax when required to do so will be liable for 100% of the amount not withheld plus related penalties and interest.

Companies in the industrial products and services sector that have not begun to assess FATCA's potential impact on them and create a customized action plan may be falling behind. They need to determine how FATCA will affect their organizations and what changes to processes and procedures may be required. Such an analysis requires an understanding of the types of entities in a company's global corporate structure that may be subject to FATCA and which payment types create new or different information reporting and tax withholding obligations.

PwC can help your company understand how FATCA works, determine whether your company needs to make any changes to comply with FATCA, and understand how your company can leverage your existing documentation, information reporting, and tax withholding processes and procedures to ensure FATCA compliance.

Let's talk

For more information about how FATCA might affect your company, please contact:

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