
US Treasury and IRS provide good faith transitional relief under FATCA

May 4, 2014

In brief

On May 2, 2014, the US Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) announced in Notice 2014-33 (the Notice) 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 the Foreign Account Tax Compliance Act (FATCA or Chapter 4). In addition, the Notice provides that this transition period will apply with respect to certain related due diligence and withholding provisions under Chapters 3 and 61 and Section 3406 of the Internal Revenue Code (Code) that were revised in coordinating regulations issued on February 20, 2014. This relief means that the IRS will take into account the extent to which withholding agents, foreign financial institutions (FFIs), and other entities are making a good faith effort to comply with FATCA and the modifications to existing information reporting and withholding obligations until calendar year 2016.

The Notice also announces that the Treasury and IRS intend to amend the regulations under Chapters 3 and 4 of the Code to provide that:

- FFIs and withholding agents may treat an obligation (including an account) held by an entity (but not an individual) that is opened, executed, or issued on or after July 1, 2014, and before January 1, 2015, as a preexisting obligation for purposes of Sections 1471 and 1472 in Chapter 4 (subject to certain modifications).
- The requirements of a limited FFI or branch of an FFI (including a disregarded entity owned by an FFI) that is a member of an expanded affiliated group (EAG) of FFIs will be modified.
- The standards of knowledge under Chapter 3 will be modified for withholding agents under Treas. Reg. § 1.1441-7(b) for accounts documented before July 1, 2014.
- The description of an individual's reasonable explanation of foreign status for purposes of Chapters 3 and 4 will be revised.

The Notice states that the transition period and other guidance described in the Notice are intended to facilitate a smooth and orderly transition for withholding agents and FFIs to comply with FATCA's requirements. According to the Notice, these provisions are in response to comments from stakeholders regarding certain aspects of the regulations under Chapters 3 and 4.

In detail

Transitional enforcement period

The Notice announces that calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration of the provisions of FATCA. The same period of time will also be treated as transitional for enforcement and administration of certain modified rules relating to reporting and withholding on payments made to non-US and US persons under Chapters 3 and 61 and Section 3406 of the Code.

With respect to this transition period, the IRS will take into account the extent to which a person (i.e., a withholding agent, an FFI, etc.) has made a good faith effort to comply with the relevant due diligence, reporting, and withholding provisions in determining whether to assess penalties and amounts due for under-withholding or take administrative action (i.e., deeming the FFI to be a nonparticipating FFI (NPFFI)). The IRS will also consider the good faith efforts of a participating FFI (PFFI), registered deemed-compliant FFI, or limited FFI to identify and facilitate the registration of each member of its EAG as required for purposes of satisfying the EAG requirements.

Observation: Recognizing that many entities have made good faith efforts to comply with the constant stream of guidance, the Treasury and IRS are clearly focused on taxpayers that have postponed taking any significant action to be FATCA compliant. While now is the time to assess and implement the processes and procedures to be compliant with US information reporting and withholding obligations, it is clear that this process should be well documented.

Treatment of an obligation (including an account) held by an entity that is opened, executed, or issued on or after

July 1, 2014 and before January 1, 2015

The Notice indicates that the Treasury and IRS intend to amend the Chapter 4 regulations to allow FFIs and withholding agents to treat an obligation held by an entity that is issued, opened, or executed on or after July 1, 2014 and before January 1, 2015 as a preexisting obligation for purposes of FATCA's due diligence, withholding, and reporting requirements. Although such accounts will be treated as preexisting entity accounts, the \$250,000 documentation exception for preexisting entity accounts of an FFI will not apply.

As the relief is limited to entity accounts, an FFI still must have procedures in place by July 1, 2014 to document new individual account holders and to apply FATCA withholding on withholdable payments to individual account holders where required.

Observation: The Notice highlights that the new Form W-8BEN for individuals was finalized in March 2014, providing approximately four months from the date of release to implement the new form. This is short of the six month implementation period that generally applies to a newly revised Form W-8. The Notice also indicates that the Treasury and IRS believe that the process for documenting an individual is less complicated than documenting accounts held by entities. This underlines the importance of having distinct processes for documenting a payee as either an individual or entity.

The relief however does not extend the end dates for the preexisting entity due diligence periods. Thus, for example, prima facie FFIs (including prima facie FFIs with obligations issued, opened, or executed on or after July 1, 2014) must still be documented by December 31, 2014. All other

preexisting entity accounts must be documented by June 30, 2016.

Moreover, the regulatory provisions that require the application of FATCA withholding prior to the end of the due diligence period where a preexisting entity documents itself as an NPFFI or as a passive nonfinancial foreign entity that fails to provide the requisite information regarding its substantial US ownership will also apply to obligations issued, opened, or executed on or after July 1, 2014.

Observation: The Notice uses a documented NPFFI as an example of when FATCA withholding is required on a preexisting account prior to January 1, 2015. This requirement to withhold on a preexisting account is accelerated if the account holder documents itself as an NPFFI, limited FFI, limited branch or passive NFFE that fails to properly document its substantial US owners. This was the case under the FATCA regulations and this Notice does not change this requirement.

According to the Notice, Treasury intends to update Annex I of the Model 1 and Model 2 intergovernmental agreements (IGAs) to incorporate this relief in the same manner as described heretofore. A partner jurisdiction with an IGA that has been signed or that has reached an agreement in substance will be permitted to adopt the revised due diligence procedures pursuant to the most-favored nation provision contained within its IGA once an IGA with the revised procedures has been signed with another partner jurisdiction.

Modification to the standards of knowledge for withholding agents under Chapter 3 for accounts documented before July 1, 2014

The Notice provides that the Treasury and IRS intend to amend the temporary coordinating regulations to

provide that a direct account holder will be considered documented prior to July 1, 2014, without regard to whether the withholding agent obtains renewal documentation for the account holder on or after July 1, 2014, pursuant to the requirements of Chapter 3. Therefore, a withholding agent that has documented a direct account holder prior to July 1, 2014 is not required to apply the new reason to know standards relating to a US telephone number or US place of birth unless the withholding agent is notified of a change in circumstances with respect to the account holder's foreign status (other than renewal documentation) or is reviewing documentation for the account holder that contains a US place of birth.

Observation: *Withholding agents and FFIs may need to revisit policies and procedures with respect to preexisting accounts to incorporate a review for any US telephone numbers or a US place of birth in the event there is a change in circumstance or if documentation discovered in the file or received after July 1, 2014 reflects a US place of birth. These instances will require cure documentation.*

A revision to the definition of a reasonable explanation of foreign status under Chapter 4

According to the Notice, the Treasury and IRS intend to amend the final Chapter 4 regulations to adopt the description of a reasonable explanation of foreign status provided in Chapter 3 which permit an individual to provide a general reasonable explanation. Previously, the final Chapter 4 regulations limited the contents of a reasonable statement provided by an individual account holder to a predetermined statement described in the regulations.

Observation: *Organizations should continue to either identify what constitutes a reasonable explanation or escalate such instances so that*

policies can be enforced on a consistent basis.

Additional guidance for limited FFIs and limited branches

The Notice indicates that the Treasury and IRS intend to modify the requirements for limited FFIs and limited branches. The changes are being made in response to comments from stakeholders who noted that local law in certain jurisdictions is preventing FFIs and branches from registering with the IRS and agreeing to the terms for limited FFI and limited branch status.

For example, stakeholders have noted that restrictions on opening accounts that are treated as US accounts may be prohibited in some jurisdictions due to requirements under local law to provide individual residents access to banking services. In addition, restrictions on opening accounts held by NPFFIs may prevent an FFI or branch from securing financing from other FFIs in the same jurisdiction that encounter similar impediments in meeting the conditions for limited FFI or limited branch status.

Stakeholders also noted that some jurisdictions explicitly prohibit an FFI resident in, or organized under the laws of, the jurisdiction from registering with the IRS or agreeing to the terms of any FATCA status, including limited FFI and limited branch status. To address these local law restrictions on account opening and registration, the Notice provides that the Treasury and IRS will amend the Chapter 4 regulations.

Account opening restrictions

The final Chapter 4 regulations will be amended to permit a limited FFI or limited branch to open US accounts and accounts for NPFFIs if the account holder is resident in the jurisdiction where the limited branch or limited FFI is located, and provided that:

- The limited FFI or branch does not solicit US accounts or NPFFIs that are not resident or established in the jurisdiction that the FFI or branch is located.
- The FFI or branch is not used by another FFI in its EAG to circumvent the FATCA obligations of such other FFI.

Registration restrictions

The final Chapter 4 regulations will also be amended to provide that, if an FFI is prohibited under local law from registering as a limited FFI, the prohibition will not prevent the other members of its EAG from obtaining statuses as PFFIs or registered deemed-compliant FFIs, if the limited FFI is identified as a limited FFI on the FATCA registration website by a member of its EAG that is a US financial institution or an FFI seeking status as a PFFI (including a reporting Model 2 FFI) or reporting Model 1 FFI.

The Notice describes the procedure to identify the limited FFI in these circumstances. According to the Notice, the member of the limited FFI's EAG that makes the identification will be required to register as a Lead FI with respect to the limited FFI and provide the limited FFI's information in Part II of the FATCA registration website. If the Lead FI is prohibited from identifying the limited FFI by its legal name, entering 'Limited FFI' and indicating the limited FFI's jurisdiction of residence or organization will be sufficient.

According to the Notice, if a limited FFI is identified in this manner on the FATCA registration website, the Lead FI is confirming that:

- The limited FFI made a representation to the Lead FI that it will meet the conditions for limited FFI status.

- The limited FFI will notify the Lead FI within 30 days of the date that such FFI ceases to be a limited FFI because it either can no longer comply with the requirements for limited status or failed to comply with these requirements or that the limited FFI can comply with the requirements of a PFFI or deemed-compliant FFI and will separately register, to the extent required, to obtain its applicable Chapter 4 status.
- The Lead FI, if it receives such notification or knows that the limited FFI has not complied with the conditions for limited FFI status or that the limited FFI can comply with the requirements of a PFFI or deemed-compliant FFI, will, within 90 days of such notification or acquiring such knowledge, update the information on the FATCA registration website accordingly and will no longer be required to act as a Lead FI for the limited

FFI. If the limited FFI can no longer comply or failed to comply with the requirements of limited FFI status, the Lead FI must delete the FFI from Part II of the FATCA registration website and must maintain a record of the date on which the FFI ceased to be a limited FFI and the circumstances of the limited FFI's non-compliance that will be available to the IRS upon request.

Observation: *Although the Notice provides welcome relief for EAGs with limited FFIs, organizations may have to adjust their legal entity management process to include real time review of each limited FFI's compliance as well as updating the registration status for FFIs that can no longer comply with limited status.*

The takeaway

In general, the Notice grants needed but cautionary relief to taxpayers subject to FATCA. Organizations working diligently and documenting their efforts to comply with the FATCA requirements need not fear IRS enforcement action until a reasonable period of time to reach compliance has elapsed. However, the relief is designed to be limited in scope and does not represent a delay in the start of FATCA. Accordingly, many of the provisions of FATCA are effective on July 1, 2014 and so the pressure is still on organizations to achieve FATCA compliance as soon as possible. Likewise, governments will hopefully continue to work to remove the legal impediments to FATCA compliance. Accordingly, the status of IGAs as well as the expected changes under local law should continue to be monitored. Waiting until 2016 to become FATCA compliant will simply be too late.

Let's talk

For more information on how FATCA might impact your business, please contact a member of the PwC's Global Information Reporting Network.

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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.