
FATCA FAQs: Frequently asked questions on the Foreign Account Tax Compliance Act

October 2011



1. *What is FATCA?*

FATCA is an acronym for The Foreign Account Tax Compliance Act (FATCA) which was introduced in October 2009, but ultimately enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act on March 18, 2010 (P.L. 111-147). FATCA creates a new tax information reporting and withholding regime for payments made to certain foreign financial institutions and other foreign persons. The provisions of FATCA have a staggered implementation timeline, with requirements initially affecting new accounts opened at US financial institutions beginning January 1, 2013.

2. *What is the intent of FATCA?*

FATCA is intended to increase transparency for the Internal Revenue Service (IRS) with respect to US persons that may be investing and earning income through non-US institutions. While the primary goal of FATCA is to gain information about US persons, FATCA imposes a withholding tax where the applicable documentation and reporting requirements are not met.

3. *Does FATCA replace the existing US tax withholding and reporting regimes?*

No. It does not replace the existing US tax withholding and reporting regimes. It does, however, add additional requirements and complexity to the existing regimes. The IRS has expressed its intent to eliminate duplicative reporting and withholding where possible.

4. *Who does this legislation impact?*

FATCA is far reaching and can impact any person, US or foreign, to the extent that such person is involved in making or receiving payments that fall within the scope of FATCA. While FATCA certainly affects US withholding agents and US multinational companies, the greatest impact will likely be to foreign financial institutions (FFIs).

5. *What are the withholding requirements under FATCA?*

In general, a withholding agent is required to withhold 30% on a withholdable payment made to a foreign financial institution (FFI) or to a non-financial foreign entity (NFFE), unless the FFI or NFFE meets certain requirements. In addition, an FFI must withhold 30% on any passthru payment it makes to a recalcitrant account holder, as well as any passthru payment it makes to another FFI unless that FFI meets certain requirements.

6. *Who is a withholding agent?*

A withholding agent is any US or non-US person (including an individual, corporation, partnership, trust, association, or any other entity) that has control, receipt, custody, disposal, or payment of any withholdable payment.

7. *What types of payments will be subject to FATCA withholding?*

FATCA withholding generally applies to two defined payment types: 1) Withholdable Payments and 2) Passthru Payments. However, FATCA withholding is not required with respect to any payment under, or gross proceeds from the disposition of, a grandfathered obligation.

8. *What is a withholdable payment?*

In the simplest of terms, a withholdable payment is a payment of either: US source income that is fixed or determinable, annual or periodical (FDAP) income; or gross proceeds from the sale or other disposition (including redemption) of property that can produce US source interest or dividend income.

For example: Interest income earned on a US Treasury bond is a withholdable payment, and the gross proceeds from the sale or other disposition of a US Treasury bond is a withholdable payment.

9. What is FDAP income?

FDAP income is fixed or determinable annual or periodical gains, profits, and income, and includes payments such as interest (including original issue discount), dividends, rents, salaries, wages, premiums, and annuities.

10. What is a passthru payment?

The definition of a passthru payment is very broad and includes any withholdable payment and any other payment to the extent it is attributable to a withholdable payment.

11. What is the purpose of the passthru payment concept in FATCA?

One primary purpose of the passthru payment concept is to prevent an FFI from being a “blocker” for US persons trying to avoid US tax by making indirect investments in US assets. It is also anticipated that foreign financial institutions will be incentivized to become participating FFIs in order to avoid excessive withholding on passthru payments.

12. What is a grandfathered obligation?

A grandfathered obligation is an obligation that is outstanding on March 18, 2012 (two years from the date that FATCA was enacted). Interest and gross proceeds from the sale or other disposition of a grandfathered obligation is exempt from FATCA withholding. Preliminary guidance indicates that a grandfathered obligation is defined as any legal agreement that produces or could produce passthru payments (including withholdable payments), but does not include any instrument that is treated as equity for US tax purposes, or any legal agreement that lacks a definitive expiration or term (for example, savings deposits, demand deposits, and other similar accounts are not grandfathered obligations because they lack a definitive term). In addition, a legal agreement that produces withholdable payments does not include brokerage, custodial and similar agreements to hold financial assets for the account of others and to make and receive payments of income and other amounts with respect to such assets. Finally, any material modification (which is determined based on the relevant facts and circumstances) to a grandfathered obligation will cause it to lose its grandfathered status.

An example of a grandfathered obligation is a US Treasury Bond that was outstanding on March 18, 2012, and that has not been materially modified after March 18, 2012.

13. Who is a recalcitrant account holder?

Generally, a recalcitrant account holder is any account holder that (1) fails to comply with reasonable requests for information necessary to determine if the account is held by a US person; (2) fails to provide the name, address, and TIN of each “specified United States person” and each substantial United States owner of a United States owned foreign entity; or (3) fails to provide a waiver of any foreign law that would prevent a foreign financial institution from reporting information required under FATCA.

14. What is a US person?

The term “United States person” means:

- A citizen or resident of the United States.
- A domestic partnership.
- A domestic corporation.
- Any estate other than a foreign estate.
- Any trust if:
 - A court within the United States is able to exercise primary supervision over the administration of the trust; and
 - One or more United States persons have the authority to control all substantial decisions of the trust.
- Any other person that is not a foreign person.

15. Who is a specified US person?

A specified US person is any US person except for:

- A corporation whose stock is regularly traded on an established securities market (and any corporation which is a member of the same expanded affiliated group as a corporation whose stock is regularly traded on an established securities market);
- An entity that is exempt from US Federal income tax under the Internal Revenue Code (IRC) Section 501(a);
- An Individual Retirement Plan;
- The US government or any wholly owned agency or instrumentality of the US government;
- A state, the District of Columbia, a possession of the US, any political subdivision or wholly owned agency or instrumentality of a state, the District of Columbia or a possession of the US;
- Banks, real estate investment trusts (REITs) and regulated investment companies (RICs);
- A common trust fund (as defined in IRC Section 584(a)); and
- A trust that is exempt from federal tax under IRC Section 664(c), or that is defined in IRC Section 4947(a)(1).

16. How is an FFI defined under FATCA?

The definition of an FFI is very broad and is expected to encompass a number of entities generally not considered to be financial institutions. An FFI is any foreign entity that:

- Accepts deposits in the ordinary course of a banking or similar business;
- As a substantial portion of its business holds financial assets for the account of others; or
- Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including a futures or forward contract or option) in such securities, partnership interests, or commodities.

Accordingly, the term financial institution may include among other entities, investment vehicles such as hedge funds and private equity funds.

17. Are any foreign entities exempt from FATCA withholding on their income?

Yes. Certain foreign entities are exempt from FATCA withholding. The Statute provides that a withholding agent does not need to perform FATCA withholding on payments if the beneficial owner is:

- Any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing;
- Any international organization or any wholly owned agency or instrumentality thereof;
- Any foreign central bank of issue; or
- Any other class of persons identified by the IRS or US Department of the Treasury (US Treasury) as posing a low risk of tax evasion.

18. Other than the exemptions in the statute, are any other foreign entities expected to be excluded from being FFIs?

Yes. Preliminary guidance from the IRS and US Treasury indicates the following entities will not be FFIs, and will instead be treated as NFFEs. Treasury and IRS intend to exempt payments beneficially owned by these entities from FATCA withholding, but rules on how to qualify for these exemptions have not yet been provided:

- Certain holding companies – limited to entities whose primary purpose is to act as a holding company for a subsidiary or group of subsidiaries that primarily engage in a trade or business other than that of a “financial institution.”
- Start-up companies – applies to certain entities that invest capital into assets with the intent to operate a business other than that of a “financial institution,” but is not yet operating the business. This exclusion only applies to the first 24 months after the entity’s organization. After such time, a foreign entity will no longer qualify for this particular exclusion.
- Liquidation or Bankruptcy – non-financial entities that are liquidating or emerging from reorganization or bankruptcy. This exception only applies if the entity was not a financial institution before beginning the liquidation or reorganization process.
- Hedging or financing centers of a non-financial group – an entity that primarily engages in financing and hedging transactions with or for members of its expanded affiliated group that are not FFIs and that does not provide such services to non-affiliates, may only be excluded from the definition of a financial institution if the expanded affiliated group is primarily engaged in a non-financial institution business.
- Certain insurance companies – entities whose business consists solely of issuing insurance or reinsurance contracts without a cash value.

19. What is a financial account?

With respect to a financial institution, a financial account is:

- Any depository account maintained by the financial institution;
- Any custodial account maintained by the financial institution; and
- Any equity or debt interest in such financial institution (other than interests that are readily tradable on an established securities market).

20. What is a participating FFI?

An FFI that enters into a FFI agreement with the IRS is referred to as a “participating foreign financial institution” (PFFI). An FFI that does not enter into an agreement with the IRS is referred to as a “non-participating foreign financial institution” (NPFFI), and is subject to withholding under FATCA.

21. What does an FFI Agreement require an FFI to do?

An FFI Agreement is an agreement between the IRS and a FFI. Although the IRS has not yet made a version of the agreement available, it is expected that the provisions of the agreement will require an FFI to perform the following functions:

- Obtain information on account holders that is necessary to determine if accounts are US accounts;
- Comply with any required due diligence and verification procedures;
- Report information on US accounts;
- Deduct and withhold a 30% tax on “passthru payments” paid to account holders who do not provide the required information (“recalcitrant account holders”), or to another FFI that does not meet the requirements of Section 1471 (e.g., does not enter into an FFI agreement);
- Comply with IRS information requests; and
- Attempt to obtain from US accounts a waiver of applicable bank secrecy or other information disclosure limitations, and close the US accounts if a waiver is not obtained within a reasonable period of time.

22. *When does an FFI need to enter into an agreement?*

An FFI must enter into an agreement with the IRS by June 30, 2013, to ensure that it will be identified as a participating FFI in sufficient time to allow US withholding agents to refrain from FATCA withholding beginning on January 1, 2014. FFIs that enter into agreements before July 1, 2013 will be participating FFIs effective on July 1, 2013.

23. *What is an FFI EIN?*

In supplemental guidance, the IRS noted that each participating and deemed compliant FFI will be issued an employer identification number (FFI EIN) which will be used to identify the entity. Until the IRS begins issuing FFI EINs, withholding agents and participating FFIs will be able to rely on certifications provided by FFIs as to their status unless the withholding agent or participating FFI knows or has reason to know a certification is incorrect. The specifics for the certification and the issuance of FFI EINs are not yet available.

24. *What is a deemed compliant FFI?*

Certain FFIs will not be required to enter into an FFI Agreement with IRS in order to be exempt from FATCA withholding. These FFIs are referred to as deemed-compliant FFIs. These FFIs will be required to: (a) apply for deemed-compliant status with the IRS; (b) obtain an FFI EIN from the IRS; and (c) certify to the IRS every three years that they meet the requirements for deemed-compliant status. Deemed-compliant status is reserved for a class of entities that Treasury has deemed to pose a low risk of tax evasion, such as certain local banks, local FFI members of participating FFI groups, and certain investment vehicles.

25. *What is the definition of an NFFE?*

An NFFE is a foreign entity that is not a financial institution.

26. *Are all NFFEs subject to FATCA withholding?*

FATCA withholding is not required on a payment to a NFFE if the payment is beneficially owned by:

- Any corporation whose stock is regularly traded on an established securities market;
- Any corporation that is a member of the same expanded affiliated group as a corporation whose stock is regularly traded on an established securities market;
- Any entity organized under the laws of a US possession and wholly owned by one or more bona fide residents of the possession;
- Any foreign government, any political subdivision of a foreign government, or any wholly owned agency or instrumentality of one or more of them;
- Any international organization or wholly owned agency or instrumentality of an international organization;
- Any foreign central bank of issue; and
- Any other class of persons identified by the IRS or US Treasury as posing a low risk of tax evasion.

27. *What is a US owned foreign entity?*

A “US owned foreign entity” is a foreign entity which has one or more substantial United States owners.

28. *What is a substantial US owner?*

Generally, a substantial US owners is a “specified US person” that owns more than 10% of the foreign financial institution, or any percentage greater than zero if the foreign financial institution is a collective investment vehicle (i.e. foreign private equity or hedge fund).

29. *If an FFI does not hold any US investments, must it still enter into an FFI agreement with the IRS in order to avoid FATCA withholding?*

Yes. A non-participating FFI that does not hold any direct US investments may still be subject to FATCA withholding if it receives passthru payments.

30. *Are US branches of foreign entities excepted from the definition of an FFI?*

No. While there is no such exemption, income that is effectively connected with a US trade or business is expected to be excluded from the definition of a withholdable payment. However, the exclusion does not apply to all payments made to an FFI's US branch (e.g., the exclusion does not apply to withholdable payments that a US branch of an FFI receives on behalf of its account holders, rather than for its own account).

31. *Will controlled foreign corporations (CFCs) that are FFIs be treated as deemed compliant FFIs under FATCA?*

No. The guidance requires CFCs (generally a non US corporation with a US shareholder that owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote) that meet the definition of an FFI to become PFFIs by entering into an FFI agreement with the IRS. This is the case despite the fact that CFCs already have certain US tax withholding and reporting requirements as US payers.

32. *What information must an FFI report to the IRS regarding US accounts?*

Unless it elects to report as if it is a US person, a participating FFI must report certain information to the IRS with respect to US accounts it maintains. The extent to which reporting is required is also staggered, with simplified reporting on calendar year 2013 balances due on September 30, 2014 and full FATCA reporting beginning in calendar year 2014. Among the items expected to be reported for calendar year 2014 are:

- The name, address and US tax identification number (TIN) of each account holder that is a specified US person;
- In the case of any account holder that is a US owned foreign entity, the name, address and TIN of each substantial US owner of such entity;
- The account number;
- The year-end account balance or value; and
- Gross receipts and gross withdrawals or payments from the account.

33. *What are “gross receipts and gross withdrawals or payments” in the case of depository accounts and custody accounts?*

With respect to depository accounts and custody accounts, gross receipts and gross withdrawals means:

- The gross amount of dividends paid or credited to the account;
- The gross amount of interest paid or credited to the account;
- Other income paid or credited to the account; and
- Gross proceeds from the sale or redemption of property paid or credited to the account with respect to which the FFI acted as a custodian, broker, nominee, or otherwise as an agent for the account holder.

34. What are “gross receipts and gross withdrawals or payments” in the case of accounts that are not depository accounts and custody accounts?

With respect to accounts that are not depository accounts or custody accounts, gross receipts and gross withdrawals or payments means the gross amount of all distributions, interest, and similar amounts credited during the year and each redemption payment made during the year.

35. In addition to information regarding US accounts, is there other information that a participating FFI must report to the IRS?

An FFI also needs to report to the IRS annually:

- The number and aggregate value of financial accounts held by recalcitrant account holders;
- The number and aggregate value of financial accounts held by related or unrelated NPFIs; and
- The number and aggregate value of financial accounts held by recalcitrant account holders that have US indicia.

36. What are the consequences of having an account that has “indicia” of US status?

If an account has indicia of US status, the FFI must obtain documentation to establish the status (US or non-US) of the account holder. If documentation is not obtained to establish that the account is not a US account, the FFI will be required to report the account to the IRS as either a US account or a recalcitrant account and may have to withhold FATCA tax on certain payments made to the account.

37. What are indicia of US status for accounts owned by individuals?

Generally, the following information is indicia of US status for an account owned by an individual:

- US citizenship or a lawful permanent US resident;
- US place of birth;
- Residence address or correspondence address in the US (including a US post office box);
- Standing instructions to transfer funds to an account maintained in the US or directions regularly received from a US address;
- An “in care of” or “hold mail” address that is the sole address with respect to the client; and
- Power of attorney or signature authority granted to a person with a US address.

38. How will the IRS ensure that participating FFIs complete the customer identification procedures for pre-existing individual accounts?

Although the entire process of auditing and validating that a participating FFI is in compliance is still unknown, the IRS has provided that a participating FFI’s chief compliance officer or other equivalent-level officer (responsible officer) will be required to certify that the procedures for identifying pre-existing accounts have been completed. Treasury and the IRS intend to provide future guidance on the timing and specifics of these certifications.

39. *With respect to an FFI, what is an expanded affiliated group?*

Withholding, reporting, and other requirements imposed upon an FFI under FATCA will also apply to each other FFI which is a member of the same expanded affiliated group (FFI Group) that includes the FFI. For these purposes, the expanded affiliated group is determined in rules similar to the affiliated group concept under IRC Section 1504(a) except that "more than 50 percent" replaces "at least 80 percent" each place it appears. An expanded affiliated group includes partnerships, insurance companies and foreign corporations.

40. *Does FATCA apply to FFI affiliates in an FFI group?*

Treasury has indicated that regulations will require that each FFI affiliate in an FFI Group must be a PFFI or a deemed compliant FFI. Each FFI affiliate in the FFI Group that becomes a PFFI must execute an FFI Agreement with the IRS, and each PFFI will be responsible for its own due diligence, withholding, reporting, and return filing requirements under its FFI Agreement. In addition, each FFI affiliate will be issued its own FFI-EIN.

41. *What is an NFFE required to do in order to avoid FATCA withholding?*

In general, in order to avoid 30% FATCA withholding, an NFFE (other than an excepted NFFE) must provide the withholding agent with either:

- A certification that the NFFE does not have any substantial US owners (i.e., owners with a more than 10% interest); or
- The name, address, and US Taxpayer Identification Number (TIN) of each substantial US owner.

Where the NFFE provides information in regard to substantial US owners, the withholding agent must report that information to the IRS.

42. *How will third party insurance or investment products be treated for FATCA?*

Treasury and the IRS do not view the issuance of insurance or reinsurance contracts without cash value as posing a high risk of tax evasion. These would include, for example, most property and casualty insurance or reinsurance contracts or term life insurance contracts. Accordingly, Treasury and the IRS plan to issue regulations treating entities whose business consists solely of issuing such contracts as NFFEs.

However, other contracts such as life insurance (other than term life insurance contracts without cash value) or annuity contracts typically combining insurance protection with an investment component will require an insurance company to be treated as an FFI. Thus, such cash value insurance contracts or annuity contracts may present the risk of US tax evasion that FATCA is designed to prevent. Treasury and the IRS are considering the appropriate treatment of entities that issue cash value insurance contracts, annuity contracts, or similar arrangements.

43. *Is a pension fund an FFI under FATCA?*

Yes. A pension fund is a financial institution under FATCA. However, it is anticipated that pension funds may qualify for an exemption from FATCA as entities that pose a low risk of tax evasion. It is anticipated that a pension fund will be exempt from FATCA withholding if it meets the following criteria:

- Qualifies as a retirement plan under the laws of the country in which it is established;
- Is sponsored by a non-US employer; and
- Does not allow US participants or beneficiaries other than employees who worked for the non-US employer in the country in which the retirement plan is established during the period in which benefits accrued.

44. How will FATCA affect Qualified Intermediaries (QI), Foreign Withholding Partnerships (FWP), and Foreign Withholding Trusts (FWT)?

Treasury and the IRS have indicated that they intend to amend the QI, FWP and FWT agreements to require these FFIs to become participating or deemed-compliant FFIs. All qualified intermediary agreements, withholding foreign partnership agreements, and withholding foreign trust agreements of entities qualifying as FFIs that expire on December 31, 2012, will be automatically extended until December 31, 2013. Finally, any FFI that enters into an FFI Agreement on or before December 31, 2013, will be considered to have renewed its qualified intermediary agreement, withholding foreign partnership agreement, or withholding foreign trust agreement, as the case may be.

45. When will final regulations be issued?

The timing of when final regulations will be issued is not clear at this point. FATCA legislation was enacted on March 18, 2010; the legislation itself was in some respects merely directional guidance for Treasury to develop the detailed FATCA rules via regulations. To date, no regulations have been issued. However, there has been guidance issued by Treasury and the IRS in the form of three notices –

- Notice 2010-60 which is generally referred to as preliminary guidance;
- Notice 2011-34 which is generally referred to as supplemental guidance; and
- Notice 2011-53 which is generally referred to as the Chapter 4 implementation notice.

These notices do not address all of the open issues, and in some cases, raise additional questions. Treasury and the IRS anticipate issuing proposed regulations by the end of 2011 and final regulations by the summer of 2012. Treasury and the IRS also anticipate issuing draft versions followed by final versions of an FFI agreement and reporting forms for use by withholding agents and participating FFIs in the summer of 2012.

46. When does FATCA withholding begin?

FATCA withholding on US source fixed or determinable, annual or periodical (FDAP) income will generally begin on January 1, 2014; however, FATCA withholding on other passthru payments and gross proceeds from the disposition of securities that could produce US source interest or dividends will be effective on January 1, 2015.

47. Is there any chance that FATCA will be repealed or get postponed?

It is not likely that FATCA will be repealed. However, Treasury and IRS have stated that will continue to work closely with businesses and foreign governments to implement FATCA effectively.

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