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## Long-awaited proposed FATCA regulations issued on 8 February 2012

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The proposed FATCA regulations have finally been released. Given the length and complexity of the regulations, we will assess and communicate their full impact in the coming days.

The new regulations appear to try and mitigate some of the operational burden imposed on financial institutions. The **customer due diligence has been simplified** from the previous Notices, for example eliminating the specific rules for private banking customers. There is **limited guidance** on the rules in respect of **passthru payments**, however the withholding on these has been deferred until 1 January 2017. There has also been a **significant expansion of those financial institutions which may be deemed-compliant** under FATCA.

Simultaneously **a joint statement was released by the governments of the United States, France, Germany, Italy, Spain and the United Kingdom, stating that they are exploring a common approach to FATCA implementation through domestic reporting (US persons) and reciprocal automatic information exchange**. In practice, this is likely to mean that Foreign Financial Institutions ("FFIs") in these countries will be able to report the information required to be compliant under FATCA to their local government agencies as opposed to the IRS directly. However there is no indication that the information to be reported will be any different.

Therefore the information gathering which FFIs will still need to undertake in relation to their customers is likely to remain a significant challenge.

There are also many areas where further guidance is expected. Some of these are detailed below, but include the draft agreement that FFIs will be required to enter and some of the forms that will be used to report information.

On February 8, 2012, the Department of Treasury ("Treasury") and Internal Revenue Service ("IRS") issued the long-awaited proposed regulations providing guidance for foreign financial institutions ("FFIs"), non-financial foreign entities ("NFFEs"), and U.S. withholding agents to implement various provisions under the Foreign Account Tax Compliance Act ("FATCA") of 2009, which was enacted as Section 501 in the Hiring Incentives to Restore Employment Act of 2010.

The proposed regulations describe detailed procedures for implementing the FATCA withholding tax and information reporting regime, and are expected to significantly affect the business practices, policies and procedures, and systems for a wide variety of financial institutions and other taxpayers globally.

Previously, Treasury and the IRS published three Notices that set forth preliminary guidance describing certain priority issues for the implementation of FATCA. The proposed regulations incorporate principles introduced in the Notices as well as comments received from stakeholders.

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*PwC Observation: In issuing the proposed regulations, Treasury and the IRS appear to have listened carefully to, and made an effort to address comments received from, many stakeholders to minimise the overall burden imposed on financial institutions. The IRS also has recognised the need to provide sufficient lead time for systems development and necessary process changes by further postponing the imposition of withholding tax on certain passthru payments.*

*The IRS also requested comments on a number of issues -- such as certifying compliance with an FFI agreement and the administration of passthru payment withholding -- that are expected to be addressed in final regulations to be issued at a later date.*

*Although the proposed regulations provide a great deal of detailed guidance relative to the Notices that have been issued thus far, there is still a good deal of guidance to come in the form of a draft FFI Agreement, modified withholding certificates (e.g., Forms W-8) and modified information returns (e.g., Forms 1042-S).*

**Among the more notable and significant changes in the proposed regulations from the previous guidance are the following:**

#### **1) Grandfathered Obligations.**

The proposed regulations increase the number of obligations that qualify for grandfathered status by including obligations outstanding as of January 1, 2013 (the Notices included obligations outstanding on March 18, 2012), and identify certain obligations (such as debt instruments, revolver credit facilities, lines of credit, certain life insurance contracts, term-certain annuity contracts, and derivatives under an ISDA master agreement) as eligible for grandfathered status.

#### **2) Transition Rule for Affiliates with Legal Prohibitions on Compliance.**

The proposed regulations provide a two-year transition rule (to January 1, 2016) for certain members of an expanded affiliated group to become a participating or deemed compliant FFI.

The transition period provides FFIs located in jurisdictions that have laws that prohibit the tax withholding or reporting required under FATCA with additional time to fully implement FATCA, without preventing other FFIs within the same expanded affiliated group from entering into an FFI agreement. However, an FFI still will need to agree to perform due diligence to identify U.S. accounts and maintain certain records during this transition period.

*PwC Observation: During this two-year transition period, an FFI member of an expanded affiliated group that does not enter into an FFI agreement will be subject to FATCA withholding on withholdable payments that it receives.*

#### **3) Additional Categories of Deemed-Compliant FFIs.**

The proposed regulations expand the categories of deemed-compliant financial institutions to reduce or eliminate the compliance burdens on entities for whom entering into an FFI agreement is not necessary to carry out the provisions of FATCA. The categories of deemed-compliant FFIs are broader than those described in the Notices. The proposed regulations generally provide for the following two types of deemed-compliant FFIs:

A "registered deemed-compliant FFI" is required to register with the IRS and declare its status as deemed-compliant and to attest to the IRS that it satisfies certain procedural requirements. This type of deemed-compliant FFI includes certain local banks, qualified investment vehicles, restricted funds, and FFIs that comply with the requirements of FATCA under an agreement between the U.S. and a foreign government.

"Certified deemed-compliant FFIs" includes non-registering local banks, certain retirement plans, non-profit organisations, certain owner-documented FFIs, and FFIs with only low-value accounts. These institutions are not required to register with the IRS, but will need to certify to withholding agents that they meet the requirements of their certified deemed-compliant category on Form[s] W-8.

#### **4) Modification of Due Diligence Procedures for the Identification of Accounts.**

The proposed regulations reduce the burden associated with reviewing records of pre-existing accounts to determine U.S. status as follows:

- a) Increasing the threshold for manual reviews to \$1,000,000 for pre-existing individual accounts.
- b) Providing guidance on the scope of a "diligent review" of paper account records (e.g., paper search).
- c) Providing a \$250,000 de minimis rule for pre-existing entity accounts, and extending the reliance on information collected during a "know your customer" or "anti-money laundering" process (KYC/AML).
- d) Eliminating the special rules in the Notices for so-called "private banking accounts."

*Note:* The proposed regulations include U.S. telephone numbers as U.S. indicia.

#### **5) Guidance on Procedures Required to Verify Compliance.**

The proposed regulations modify the guidance provided in the Notices by providing that the responsible officer of an FFI will be expected to certify that the FFI complied with the terms of the FFI agreement. In addition, verification of compliance through a third-party audit is not required.

#### **6) Definition of "Financial Account."**

The proposed regulations refine the definition of Financial Account to exclude most debt and equity securities issued by banks and brokerage firms while focusing on traditional bank, brokerage, money market accounts, and equity interests in investment vehicles.

**7) Reporting Requirements.** The proposed regulations extend the transition period on the scope of information reporting by FFIs as follows:

- a) 2014 and 2015: FFIs must begin reporting name, address, TIN, and account balance of U.S. accounts (for calendar years 2013 and 2014).

- b) 2016: FFIs must begin reporting income associated with U.S. accounts (for calendar year 2015).

- c) 2017: FFIs must begin reporting gross proceeds from securities transactions (for calendar year 2016).

**8) Passthru Payments.** The proposed regulations extend the date on which FATCA withholding begins on foreign passthru payments from January 1, 2015, to January 1, 2017. However, during this interim period an FFI must report the aggregate amount of certain payments to each non-participating FFI as a means to reduce the incentive for non-participating FFIs to use participating FFIs to block the application of the FATCA rules.

**9) Exemptions from FATCA Withholding.** The proposed regulations identify the following payments as exempt from FATCA withholding:

- a) Short-term obligations. Payments of interest and original issue discount on certain short-term obligations, and

- b) Accounts payable type payments. Payments made in the ordinary course of a withholding agent's business for non-financial services, goods, and the use of property (e.g., wages, rent, etc.).

**10) New Terms.** The proposed regulations provide a list of defined terms, many of which are used under the current withholding and reporting rules (Chapters 3 and 61). While in most cases the terms and definitions in the proposed regulations are consistent with current rules, the proposed regulations provide that Treasury and the IRS intend to review the definitions under the current rules to conform them to the definition in the proposed FACTA regulations effective January 1, 2014.

Simultaneously with the issuance of the proposed regulations, the governments of the United States, France, Germany, Italy, Spain, and the United Kingdom released a joint statement explaining that they are exploring a common approach to FATCA implementation through domestic reporting and reciprocal automatic information exchange.

The joint statement also emphasises the willingness of the United States to reciprocate by automatically collecting and exchanging information on accounts held in U.S. Financial Institutions by residents of each of the respective countries.

*PwC Observation: The joint statement confirms recent comments by Treasury officials and rumors outside the U.S. that the IRS was considering "an alternative" under which an FFI would send U.S. account information to its "residence country government" and the country government in turn would send U.S. account information to the IRS.*

*This consideration may address many of the country privacy issues, but it may ultimately increase the reporting costs for a global financial institution.*

PwC will issue additional Tax & Legal Alerts on the proposed regulations in the coming days. The first of these will contain our preliminary observations regarding the new rules, and the second will provide detailed analysis and insights into the proposed regulations.

A public hearing has been scheduled for May 15, 2012. The IRS has requested that comments be submitted by April 30, 2012.

Included below are links to the guidance released on 8 February 2012 as well as the press release and the joint statement.

Link to regulations:

The proposed rules are available at

[http://www.ofr.gov/OFRUpload/OFRData/2012-02979\\_PI.pdf](http://www.ofr.gov/OFRUpload/OFRData/2012-02979_PI.pdf)

Link to statement:

<http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf>

Link to release:

<http://www.treasury.gov/press-center/press-releases/Pages/tg1412.aspx>

On February 21, 2012, PwC will host a web-cast on the proposed regulations featuring a panel of PwC specialists who will review and analyze the regulations in depth, and discuss what steps companies should consider taking as a result of the new regulations. A link to the registration site will be open on Friday, February 10, 2012, and can be found at <http://www.pwc.com/us/fatca>.

Find more information about the FATCA regulations and our relating services in the link below [www.pwc.hu/services/fatca-foololdal.jhtml](http://www.pwc.hu/services/fatca-foololdal.jhtml)

If you have any questions regarding the proposed FATCA regulations, please contact Dr. János Kelemen (phone: +36 1 461 9310, email: [janos.kelemen@hu.pwc.com](mailto:janos.kelemen@hu.pwc.com)), Rita Kocsos (phone: +36 1 461 9377, email: [rita.kocsos@hu.pwc.com](mailto:rita.kocsos@hu.pwc.com)) or your usual relationship partner or alternatively any of the following people listed below:

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