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Round 3 of FATCA guidance: New Implementation timelines and transitional rules for Foreign Financial Institutions

Executive summary

July 14, 2011, the Internal Revenue Service (IRS) issued Notice 2011-53 ('the Notice' or 'Round 3 FATCA guidance'), which pushes back slightly the timelines for Foreign Financial Institutions (FFIs) and U.S. withholding agents to implement the various provisions under the Foreign Account Tax Compliance Act (FATCA) of 2009, which was enacted in the Hiring Incentives to Restore Employment Act of 2010. While this news will be much welcomed by all in the industry, industry experts maintain that meeting the new deadlines will still be a major challenge. The notice anticipates proposed regulations to be issued end of 2011 followed by final regulations in summer 2012.

It is important to remember that FATCA affects the whole of the Financial Services industry. However certain sectors like insurance and asset management continue to remain in the dark, as the new guidance does not provide the much needed sector specific regulation.

The Notice supplements and modifies the guidance provided in Notice 2010-60 (Round 1 FATCA guidance) and Notice 2011-34 (Round 2 FATCA guidance). Specifically, the Notice phases in the implementation of FATCA in the following manner:

- The withholding on U.S. source fixed or determinable, annual or periodical (FDAP) income will generally begin on January 1, 2014; however, withholding on pass-through payments and gross proceeds from the disposition of securities that could produce U.S. source interest and dividends will be effective on January 1, 2015.
- 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 withholding agents to refrain from withholding beginning on January 1, 2014. FFIs that enter into agreements before July 1, 2013 will be participating FFIs effective on July 1, 2013. Formerly, FFIs needed to enter into an agreement effective January 1, 2013, as withholding could have begun as early as that date.
- For participating FFIs, the due diligence requirements for identifying new and pre-existing U.S. accounts will begin in 2013. Reporting requirements will begin in 2014 (based on calendar year 2013 balances) and will be significantly simplified for the first year.

PwC observations - The Notice was accompanied by an IRS News Release (IR-2011-76), which noted that the phased implementation approach is a reflection of the IRS's serious commitment to provide FFIs and U.S. withholding agents with adequate time to build the systems needed to fully comply with FATCA, and that the Treasury and IRS will continue to work closely with businesses and foreign governments to implement FATCA effectively.

The Notice is consistent with Notice 2011-34 in that the IRS continues to focus on rules related to pre-existing accounts. The IRS has not provided any additional clarity or transition guidance on the process for new accounts since the issuance of Notice 2010-60. In fact, Notice 2011-53 emphasizes that the new account due diligence processes outlined in Notice 2010-60 remain unchanged.

Although the Notice provides important transition rules for withholding agents, especially FFIs, the Notice is silent on certain matters that are key components of FATCA's new tax information reporting and withholding regime. For example, the Notice does not address either of the following matters:

- FATCA withholding on withholdable payments to Non-Financial Foreign Entities (NFFEs) - Although the Notice provides transitional relief for FATCA withholding on pass-through payments and certain withholdable payments, the Notice is silent on transitional relief as it pertains to a withholding agent's obligation to withhold FATCA tax on withholdable payments made to NFFEs. Thus, it would appear that FATCA withholding may still apply to withholdable payments made after 2012 to a recalcitrant NFFE (i.e., an NFFE that does not disclose its substantial U.S. owners, or that fails to certify it does not have substantial U.S. owners). This requirement applies to all withholding agents. It remains to be seen whether this is intentional on the part of Treasury and IRS or is simply a drafting oversight.
- Procedures for USFIs to identify accounts - The Notice does not provide any additional guidance or transitional relief that covers a USFI's obligation under FATCA to identify its new and pre-existing accounts. Those procedures, which apply to a USFI's entity accounts (described in Notice 2010-60), remain unchanged.



Phased implementation timeline for participating Foreign Financial Institutions (FFIs)

Registration

The Notice provides that the IRS will begin to accept FFI applications through an electronic submission process no later than January 1, 2013. An FFI must apply to enter into an agreement with the IRS prior to July 1, 2013 in order to ensure that it will be identified as a participating FFI in sufficient time to allow U.S. withholding agents to refrain from withholding on payments made to a participating FFI beginning January 1, 2014. An FFI agreement entered into prior to July 1, 2013, will be effective July 1, 2013 (a six month extension from the prior effective date). For FFI agreements entered into on or after July 1, 2013, the effective date will be the date that the agreement was entered into.

PwC observation - As the IRS needs time to process applications, and withholding agents need time to verify status, an FFI that registers on or after July 1, 2013, may not be properly identified by January 1, 2014. Delaying the application for participating FFI status may result in the participating FFI being exposed to 30 percent withholding on FDAP income even though it is a participating FFI. Future guidance will be needed as to whether any accelerated refund process will be provided for these situations. Otherwise, the result may be punitive.

New accounts

An FFI will be required to put in place the account opening procedures described in Notice 2010-60, as implemented in regulations, to identify U.S. accounts opened on or after the effective date of its FFI agreement (i.e., now defined as the later of July 1, 2013, or the date the FFI enters into the FFI agreement).

Pre-existing accounts

In the Notice, the IRS bifurcated pre-existing private banking accounts into two categories. The accompanying press release identified private banking accounts with a balance greater than or equal to \$500,000 as "high-risk accounts." With respect to these high-risk accounts, a participating FFI must complete a diligent search of its electronic and paper account files for indicia of U.S. status, and have requested and obtained any required tax documentation (the private banking procedures in Notice 2011-34) within one year of the effective date of its FFI agreement.

For pre-existing private banking accounts with a balance of less than \$500,000, a participating FFI will now have until the later of December 31, 2014, or the date that is one year after the effective date of its FFI agreement, to complete the private banking account identification procedures.



For all other pre-existing accounts, a participating FFI will be required to complete the remaining due diligence procedures outlined in Notice 2010-60, Notice 2011-34, and coming regulations within two years of the effective date of its FFI Agreement.

Private banking accounts

The Notice also provides that future regulations will provide that the actual review of the private banking account files may be completed by any person designated by the participating FFI. However, the private banking relationship manager will still need to identify any client for which he or she has actual knowledge that the client is a U.S. person and request a Form W-9 from such U.S. person. Regulations will also provide that an account subject to due diligence procedures and identified as either a U.S. or non-U.S. account will not be subject to additional due diligence procedures in subsequent years unless the account undergoes a change in circumstances.

Reporting

The Notice defers and simplifies the reporting requirements relating to 2013. With respect to any account for which a participating FFI has received a Form W-9 from an account holder or from a substantial U.S. owner of a NFFE by June 30, 2014, the participating FFI generally must report to the IRS by September 30, 2014:

- The name, address, and taxpayer identification number of such person;
- The December 31, 2013, account balance (or the account balance immediately prior to account closure if the account is closed after the effective date of the FFI Agreement); and
- The account number.

In cases where a participating FFI is not able to report the required information because, for example, the account holder has not provided a waiver of any applicable reporting restrictions, the FFI must report the account as recalcitrant. The reporting required with respect to recalcitrant account holders identified by June 30, 2014, will be required to be filed with the IRS by September 30, 2014.

While this reporting represents a simplification for 2013, for subsequent tax years the reporting rules described in Notice 2010-60, Notice 2011-34, and any future regulations, will apply.

PwC observation - Although the Notice extends the time for an FFI to perform the reporting relating to 2013 and simplifies the information that must be reported, it also extends the date that an FFI must look to in order to determine reportable accounts from December 31, 2013 to June 30, 2014.

Withholding

The Notice provides for a phase-in of the FATCA withholding requirements, so that no Section 1471 withholding will be required until at least January 1, 2014. Beginning on January 1, 2014, FATCA withholding will apply only to U.S. source FDAP income. The withholding requirement on gross proceeds and pass-through payments will begin on January 1, 2015.

Other Provisions

Qualified Intermediary and other withholding agreements

The Notice provides that all qualified intermediary agreements, withholding foreign partnership, and withholding foreign trust agreements of FFIs that are scheduled to expire on December 31, 2012, will automatically be extended until December 31, 2013.

In addition, any FFI that enters into an FFI agreement prior to December 31, 2013, will be considered to have renewed its respective qualified intermediary agreement, withholding foreign partnership agreement, or withholding foreign trust agreement.

Clarification of the scope of grandfathered obligations

The Notice indicates that Treasury and the IRS intend to issue regulations modifying the definition of an obligation as any legal agreement that produces or could produce pass-through payments (including withholdable payments), but not any instrument treated as equity for U.S. tax purposes.



Guidance matrix

The Following matrix compares the guidance provided in Round 1 and 2 FATCA Notices (Notice 2010-60 and Notice 2011-34) with the guidance in Round 3 (Notice 2011-53):

FATCA requirement	Prior guidance (Round 1 & 2)	Notice 2011-53 (Round 3)
Entering Into An FFI Agreement	FFIs were expected to enter into FFI agreements prior to January 1, 2013, and any such agreement entered into prior to that date would have a January 1, 2013 effective date.	FFIs are expected to enter into FFI agreements prior to July 1, 2013, and any such agreement entered into prior to that date will have a July 1, 2013 effective date.
PFFI Due Diligence - New Accounts	An FFI was required to put in place the account opening procedures described in FATCA guidance Round 1 (Notice 2010-60), as implemented in regulations, to identify U.S. accounts opened after the effective date of the FFI's Agreement with the IRS.	No change.
PFFI Due Diligence - Pre-existing Private Banking Accounts	Diligent search of paper and electronic account files required to be conducted, and any required documentation requested and obtained within one year of the effective date of the FFI's Agreement with the IRS.	For private banking accounts with a value of \$500,000 or higher on the effective date of the FFI agreement, the due diligence rules and timeline remain the same. For private banking accounts with a value of less than \$500,000, the FFI must complete the private banking procedures by the later of December 31, 2014, or within one year of the effective date of the FFI agreement.
PFFI Due Diligence - Pre-existing Accounts Other Than Private Banking Accounts	The participating FFI must complete the due diligence procedures within two years of the effective date of the FFI agreement.	No change.
Withholding	Withholding could apply to new accounts as early as January 1, 2013.	Withholding is applicable to U.S. source FDAP income beginning on January 1, 2014. Withholding is applicable to gross proceeds and pass-through payments beginning on January 1, 2015.
Reporting	Full FATCA reporting with respect to U.S. persons and recalcitrant account holders would have been required in early 2014 with respect to calendar year 2013.	If the account was closed after the effective date of the FFI's FFI Agreement, the balance reported is equal to the balance of such account immediately before closure. Reporting with respect to 2013 is deferred until September 30, 2014, and applies to those U.S. persons that are documented as of June 30, 2014. The information to be reported has been simplified to include the name, address, TIN, December 31, 2013 account balance, and the account number. If the account was closed after the effective date of the FFI's FFI Agreement, the balance reported is equal to the balance of such account immediately before closure. Full FATCA reporting applies to accounts for 2014 and beyond.



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