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A legal update from Dechert's International and Domestic Tax Group

Final Proposed FATCA Regulations Issued

The U.S. Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") on February 8, 2012 issued proposed regulations addressing the implementation of the Foreign Account Tax Compliance Act ("FATCA," which was enacted as part of the Hiring Incentives to Restore Employment Act on March 18, 2010). For a brief overview of FATCA, please refer to our prior releases on the subject from February 2012 entitled "FATCA Update for Latest Government Guidance" or from April 2010 entitled "Recent Enactments Affecting Offshore Funds Attack Offshore Tax Abuses, Raise Taxes on Investment Income and Gains." The proposed regulations, which are nearly 400 pages in length, provide detailed guidance on the U.S. account identification, withholding and information reporting requirements which foreign financial institutions ("FFIs"), other non-financial foreign entities ("NFFEs") and U.S. withholding agents are subject to under FATCA. Throughout 2010 and 2011, Treasury and the IRS issued preliminary guidance with respect to the implementation of FATCA in a series of notices (collectively, the "FATCA Notices"). Public comments with respect to the FATCA Notices were considered by Treasury and the IRS in developing the proposed regulations and the proposed regulations in certain cases amend, revise or eliminate the preliminary guidance that was provided under the FATCA Notices. The proposed regulations make progress in eliminating, reducing or delaying the impact of FATCA on many investment funds and financial institutions, but for entities not otherwise exempt from FATCA, the burdens associated with FATCA still remain.

New Intergovernmental Approach to FATCA Implementation in Certain Jurisdictions

In conjunction with the issuance of the proposed regulations, Treasury released a joint statement with France, Germany, Italy, Spain and the United Kingdom (the "Joint Statement") regarding the adoption of an intergovernmental approach to FATCA to simplify FATCA's practical implementation, to reduce compliance burdens and costs associated with FATCA compliance, and to address legal restrictions that may prevent FFIs in these jurisdiction from complying with FATCA's reporting, withholding and account closure requirements. FATCA generally requires FFIs to enter into a comprehensive agreement with the IRS (an "FFI Agreement") whereby the FFI agrees to identify its accounts held by U.S. persons and report information with respect to those accounts to the IRS.

Under the intergovernmental approach set forth in the Joint Statement, FFIs in jurisdictions participating in the intergovernmental approach (each such jurisdiction, a "FATCA Partner") would be relieved from entering into an FFI Agreement provided that the FFI was registered with the IRS or was otherwise exempt from registration pursuant to IRS guidance or an agreement between the United States and the FATCA Partner, and payments of U.S.-source income (including interest and dividends) to the FFI would not be subject to the 30% withholding tax imposed by FATCA. Instead, the FATCA Partner would implement its own legislation requiring FFIs under its jurisdiction to identify U.S.-owned accounts and to collect and report the information

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required by FATCA directly to the FATCA Partner, and the FATCA Partner would report this information to the United States pursuant to a tax treaty or other reciprocal information-exchange agreement. Under an agreement with a FATCA Partner, the United States would also agree to collect and report to the FATCA Partner information on accounts maintained in the United States by residents of the FATCA Partner.

Major investment fund jurisdictions, including Luxembourg, Ireland and the Cayman Islands, were not identified in the Joint Statement and have not yet been identified by Treasury as potential FATCA Partners. Treasury has indicated that it hopes to expand the number of jurisdictions participating as FATCA Partners; crucial to its determination will be the willingness of potential FATCA Partners to require FFIs under their jurisdiction to obtain and report the information required by FATCA to the United States. Countries that are currently party to a tax treaty with the United States are the most likely candidates to become FATCA Partners in the future, though as of yet there has been no indication as to the next set of countries to be included in the intergovernmental approach to FATCA implementation.

Expanded Scope of Grandfathered Obligations Not Subject to FATCA

As originally enacted, withholding was not required under FATCA with respect to payments made on obligations outstanding on March 18, 2012, or with respect to the gross proceeds from the disposition of such obligations. The proposed regulations extend this grandfathering date to January 1, 2013, and provide that an "obligation" for these purposes includes a wide variety of legal agreements and instruments other than agreements that are treated as equity or that lack a stated expiration or term. For example, an obligation would include a bond, a term deposit, a line or credit or revolving credit facility with fixed material terms and a stated maturity, a term annuity contract, and a derivatives transaction entered into between counterparties under an ISDA Master Agreement and evidenced by a confirmation. An obligation does not include a brokerage agreement, custodial agreement or other similar agreements to hold financial assets for the account of others, nor does it include a master agreement that sets forth general and standard terms and conditions that are intended to apply to a series of transactions but does not set forth all of the specific terms necessary to conclude a particular contract.

An obligation is considered outstanding on January 1, 2013, if it has an issue date before January 1, 2013 (in the case of a debt obligation) or if a legally binding agreement establishing the obligation was executed prior to January 1, 2013 (in all other cases). If there is a "material modification" to an obligation on or after January 1, 2013, the obligation is treated as being newly issued or executed as of the effective date of the modification and the obligation will no longer be grandfathered for FATCA purposes. Whether a modification of an obligation is material is determined based on all relevant facts and circumstances but, in the case of a debt instrument, includes any modification that is a "significant modification" under the Treasury regulations applicable to such debt instruments.

Expanded Phase-In Rules for Withholding and Reporting

The proposed regulations generally follow the lead established in the FATCA Notices, where FATCA withholding does not generally begin until January 1, 2014 (for payments of U.S.-source fixed or determinable annual or periodical income ("FDAP"), such as interest and dividends), and which is delayed until January 1, 2015 in the case of gross proceeds from the disposition of an obligation that produces U.S.-source interest or dividends (the payments and gross proceeds to which FATCA applies being called "withholdable payments").

Information reporting by an FFI with respect to its accounts that are held by U.S. persons is also phased in. For reporting in 2014 and 2015 (with respect to calendar years 2013 and 2014), an FFI is required to report under its FFI Agreement only the name, address, taxpayer identification number ("TIN"), and account balance with respect to its accounts that are held by U.S. persons. For reporting beginning in 2016 (with respect to calendar year 2015), the FFI must also report income paid with respect to an accounts held by U.S. persons (e.g., the gross amount of interest paid with respect to a depository account, the gross amount of interest and dividends credited to a custodial account, etc.), and for reporting beginning in 2017 (with respect to calendar year 2016), full reporting with respect to gross proceeds will be required.

While an FFI is also generally required pursuant to its FFI Agreement to withhold on "passthru payments" (e.g., a withholdable payment or a payment that is attributable to a withholdable payment) that it makes to

another FFI that is not covered by an FFI Agreement (a "nonparticipating FFI") or a recalcitrant account holder (i.e., an account holder that refuses to provide the paying FFI with the necessary information to enable the FFI to determine whether the account holder is a U.S. person), this obligation is phased in over time. During the 2015 and 2016 calendar years, FFIs will be required to report to the IRS annually on the aggregate amount of certain passthru payments made to a nonparticipating FFI. Starting in January 1, 2017, the scope of passthru payments will be expanded beyond withholdable payments to include a variety of payments that are attributable to withholdable payments (as determined by future guidance), and FFIs will be required to withhold on such payments.

Exempt "Deemed Compliant" Entities

The proposed regulations also exempt additional classes of FFIs from FATCA beyond what was previously provided in the FATCA Notices. "Deemed compliant" FFIs are not required to enter into an extensive FFI Agreement with the IRS, but may be required to separately register with the IRS (a "registered deemed-compliant FFI") or certify its deemed-compliant status to a withholding agent (a "certified deemed compliant FFI").

Registered deemed-compliant FFIs include certain local foreign-country FFIs that meet certain requirements, including being licensed or regulated by the jurisdiction in which it is organized, not soliciting account holders outside of the its country of organization, and implementing policies and procedures to ensure that it does not maintain accounts for specified U.S. persons. Registered deemed-compliant FFIs also include qualified collective investment vehicles that are regulated in its country of incorporation and whose investors (including a holder of direct debt interests in excess of $50,000) include only FFIs that have entered into FFI Agreements with the IRS, registered deemed-compliant FFIs, or U.S. persons that are not subject to FATCA reporting (such as publicly-traded corporations, certain exempt organizations, etc.). Certain other restricted funds are considered registered deemed-compliant FFIs, and such funds are required to prohibit the sales of its debt or equity interests to U.S. persons, nonparticipating FFIs, or other entities that would be subject to FATCA reporting and withholding (such as certain NFFEs in which a U.S. person owns a substantial interest). Certified deemed-compliant FFIs include an FFI with only low-value accounts (i.e., no account balance in excess of $50,000) that has no more than $50 million in assets on its balance sheet, certain nonprofit organizations and certain retirement funds.

Classifying and Identifying Accounts Maintained by U.S. Persons

For those entities that are not deemed-compliant or otherwise exempted from FATCA, the proposed regulations contain extensive rules on the due diligence procedures required to identify which accounts maintained by the FFI have U.S. owners. While in many ways the proposed regulations try to relax the due diligence requirements that were set forth previously in the FATCA Notices (such as by removing the distinct procedures applicable to "private banking accounts" and instead providing for heightened levels of due diligence depending upon the overall account balance or value, with the most extensive due diligence applicable to those accounts with balances in excess of $1 million), the requirements are still extensive and may be quite onerous for non-exempt FFIs and other foreign entities to comply with. Treasury and the IRS are currently considering comments with respect to the proposed regulations and time will tell whether, when adopted in their final form, certain of these requirements will be further relaxed.

Dechert will continue to monitor developments in this area and will issue future *DechertOnPoints* as developments warrant.

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