IRS Issues Foreign Account Tax Compliance Act (FATCA) Proposed Regulations

On February 8, 2012, the Internal Revenue Service ("IRS") issued much-awaited proposed regulations (the "Proposed Regulations") that interpret sections of the Internal Revenue Code (the "Code") that were added on March 18, 2010 as part of the Hiring Incentives to Restore Employment Act (the "HIRE Act"). In general, these provisions, aimed at combatting offshore tax evasion, impose a new 30% U.S. withholding tax on certain payments made by U.S. persons to (i) non-FATCA-compliant foreign financial institutions ("FFIs") and (ii) certain non-financial foreign entities ("NFFEs"). To avoid withholding under FATCA, an FFI must enter into an agreement with the IRS whereby it agrees to identify and report on U.S.-owned accounts and to withhold on "withholdable payments" that it makes to both non-compliant FFIs and individuals, and an NFFE must report to the IRS certain information regarding its substantial U.S. owners (generally, U.S. persons owning an equity interest of greater than 10%). "Withholdable payments" consist of both "traditional" fixed or determinable annual or periodical (FDAP) income – such as interest and dividends – *and gross proceeds from the sale of property producing interest or dividends*. Thus, the new withholding regime is far broader than the withholding regime that is currently in place that requires 30% withholding on U.S.-source dividends paid to a nonresident alien, for example, but not on gross proceeds derived from the sale of the underlying stock. The government does not view FATCA withholding as a new tax, but for those persons who are unwilling to identify themselves, the withholding would act as such.

Delayed Implementation

The Proposed Regulations, in response to practitioner and industry concerns, delay the full implementation of the withholding and reporting regime. One aspect of this delay is the expansion of the scope of "grandfathered" obligations to those obligations that are outstanding as of January 1, 2013.

Reporting Timeline

The Proposed Regulations provide that identifying information (name, address, TIN and account number) and account balances are required to be reported by FFIs beginning in 2014 (with respect to 2013). Reporting on income is not required until 2016 (with respect to the 2015 calendar year) and reporting on gross proceeds is not required until 2017 (with respect to the 2016 calendar year). FFIs will be required to report on the aggregate amount of certain payments to nonparticipating FFIs beginning in 2016 for the 2015 calendar year.

Withholding Timeline

The Proposed Regulations require withholding on U.S.-source FDAP income (e.g., dividends and interest) attributable to non-grandfathered obligations beginning January 1, 2014, and expand the requirement to withholding on gross proceeds beginning January 1, 2015. Finally, the Proposed Regulations delay the implementation of withholding on "passthru" payments that are not withholdable payments (i.e., payments that are attributable to withholdable payments, but that are not themselves withholdable payments, such as distributions to shareholders) until January 1, 2017, the earliest. Additional regulations will be issued to provide guidance on passthru payments.

Excepted Entities

The Proposed Regulations provide limited carve-outs from FATCA. Certain FFIs are considered "deemed-compliant FFIs" and thus do not need to enter into an FFI agreement with the IRS to avoid withholding. The universe of deemed-compliant FFIs has been expanded by the Proposed Regulations, and now includes, in addition to certain registered investment funds and retirement plans, local banks and investment entities that meet certain requirements. The Proposed Regulations also provide deemed-compliant status for "owner-documented FFIs," which should assist entities such as offshore family investment vehicles in complying with FATCA. Furthermore, certain entities are excepted from the rules that apply to NFFEs. These include certain holding companies and intercompany financing companies, start-up entities, and "active" NFFEs.

Intergovernmental Framework

On February 8, 2012, the Treasury Department issued a joint statement with France, Germany, Italy, Spain and the United Kingdom to create an intergovernmental approach to information sharing on financial accounts, which would provide an alternative to the information sharing required under FATCA. This intergovernmental approach is in large part a response to concerns regarding conflicts of laws where, for example, an FFI may be barred by local law from reporting the information required to be reported to the IRS. Under the intergovernmental approach, FFIs in a participating country would not have to enter into a comprehensive FFI agreement directly with the IRS, assuming the FFI registered with the IRS (or was excepted from registration). ◆

If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

Henry P. Bubel	**212.336.2615**	**hpbubel@pbwt.com**
Richard R. Upton	**212.336.2020**	**rrupton@pbwt.com**
Dahlia B. Doumar	**212.336.2988**	**dbdoumar@pbwt.com**
Jenny L. Longman	**212.336.2409**	**jlongman@pbwt.com**