IRS PROVIDES FATCA IMPLEMENTATION RELIEF

July 15, 2011

To Our Clients and Friends:

Yesterday, the IRS issued limited relief regarding the implementation of the so-called "FATCA" (Foreign Account Tax Compliance Act) withholding and information reporting rules. The relief, in Notice 2011-53:

- delays until June 30, 2013 the date for a "foreign financial institution" ("FFI") to enter into a withholding agreement with the IRS to avoid being subject to 30% U.S. withholding tax under the FATCA rules;
- delays the start date for withholding tax under the FATCA rules until January 1, 2014, and for certain categories of payments until January 1, 2015; and
- clarifies that the grandfather rule applicable to fixed-term obligations (not including equity) outstanding on March 18, 2012 includes certain obligations issued by FFIs.

BACKGROUND

The FATCA rules, which were enacted with a January 1, 2013 effective date, are designed to identify U.S. persons that may be hiding their assets abroad. The rules implement an enhanced reporting regime that requires FFIs and "non-financial foreign entities" to disclose information relating to financial accounts owned by U.S. persons or foreign entities with substantial U.S. owners. For purposes of these rules, FFIs include banks and other financial intermediaries, and also include foreign investment funds.

The mechanism for the IRS to enforce compliance with the FATCA reporting rules is a new 30% U.S. withholding tax that applies to "withholdable payments." Generally, "withholdable payments" include certain U.S. source income (such as interest, dividends and rents) and gross proceeds from the sale or other disposition of property that can produce U.S. source interest or dividends. In addition, 30% withholding tax applies to "passthru payments" made by an FFI that participates in the FATCA program to (i) "recalcitrant accountholders" that do not provide information requested by the FFI and (ii) FFIs that do not elect to participate in the program.

In previous guidance, the IRS proposed a broad definition of passthru payments, which provides that any payment by a participating FFI that is not acting in a custodial capacity will be treated as a passthru payment based on the percentage of the participating FFI's worldwide assets that consist of U.S. assets. One effect of these rules is that even if a non-participating FFI or recalcitrant accountholder does not hold U.S. assets that produce withholdable payments, the FFI or accountholder generally can expect to be subject to withholding in respect of some portion of any non-custodial payment that it receives from an FFI that does participate in the program.

The FATCA rules are complex, and financial institutions have expressed serious concern regarding their ability to implement the withholding and reporting regime and the cost of compliance.

RELIEF PROVIDED

While Notice 2011-53 does not narrow the broad scope of the FATCA rules described above, it does provide limited relief regarding the implementation of the rules.

Under Notice 2011-53, the deadline for FFIs to enter into withholding agreements with the IRS, in order to avoid being subject to withholding tax, has been extended six months, from January 1, 2013 to June 30, 2013. The start date for withholding on U.S. source dividends, interest, rents and royalties has been delayed one year, from January 1, 2013 to January 1, 2014. Withholding on passthru payments and gross proceeds from the disposition of U.S. stock and debt instruments will not apply before January 1, 2015.

The FATCA withholding rules do not apply to any obligation that is outstanding on March 18, 2012. Previous IRS guidance provided that this grandfather rule applies to any legal agreements with a definitive term or expiration (not including equity) that produces U.S. source withholdable payments, which generally would not cover obligations issued by FFIs. The Notice clarifies that the grandfather rule also applies to any legal agreement that has a definitive term or expiration (not including equity) and produces or could produce passthru payments (including withholdable payments), thereby covering obligations issued by FFIs.

The Notice also eases certain aspects of the proposed reporting rules, for the first year of reporting, and provides some timing relief in relation to the due diligence procedures that participating FFIs must undertake to identify their accountholders.

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