

# Client Alert

Current Issues Relevant to Our Clients

May 30, 2014

## Notice 2014-33: Good Faith Transitional FATCA Relief

On May 2, 2014, the IRS released Notice 2014-33, offering transitional relief for the enforcement and administration of FATCA. The Notice also redefines “preexisting obligation” to include obligations that are issued on or after July 2, 2014, and before January 1, 2015.

The Treasury intends to amend the final FATCA regulations to adopt the rules summarized below. However, in the meantime, taxpayers may rely on the instructions in the Notice.

### Background: The FATCA Requirements

Foreign Account Tax Compliance Act (“FATCA”) rules were enacted in the United States in 2010 as a way to encourage tax reporting and compliance regarding assets owned by U.S. persons through foreign accounts. Under FATCA, a new 30 percent withholding is required on withholdable payments to foreign financial institutions (“FFIs”) and non-financial foreign entities (“NFFE”) unless they comply with the information-gathering and reporting requirements of FATCA. The withholding “tax” is generally called FATCA withholding and is separate from regular withholding under Code § 1441 (“Chapter 3 withholding”).

In January 2013, final regulations were published that provided a detailed framework for FATCA due diligence and reporting requirements.

In July 2013, the IRS released Notice 2013-43, which postponed the start of FATCA withholding by six months, to June 30, 2014.

On May 2, 2014, the IRS released Notice 2014-33, which provides the relief described below.

### Background: Intergovernmental Agreements (IGAs)

The United States has negotiated and signed or come to agreement in substance for IGAs with approximately 60 foreign governments, which generally provide an alternate framework to the final regulations. The IGAs allow FFIs to satisfy their FATCA reporting requirements by reporting either to their local tax authorities or directly to the IRS.

### Planned Changes to the FATCA Regulations

- Transition Period
- Preexisting Obligations
- IGAs
- Limited FFIs and Limited Branches
- Reason to Know Standard
- Reasonable Explanation of U.S. Indicia

#### Transition Period for 2014 and 2015

The calendar years 2014 and 2015 will be regarded as a transition period for IRS enforcement and administration of the due diligence required under FATCA. This means that the IRS will take into account the extent to which an FFI or a withholding entity has made a good faith effort to comply with the FATCA rules under the regulations and published notices. An FFI may not simply wait until the end of 2015 to begin implementing new account procedures. Such an FFI would not be in compliance.

The IRS will take into account whether a withholding agent has made reasonable efforts during the transition period to modify its account-opening practices and procedures to document the FATCA status of payees and apply the standards of knowledge and presumptions provided in the regulations. The IRS will also consider the good faith efforts of FFIs to identify and facilitate the registration of the other members of their expanded affiliated group.

### Definition of “Preexisting Accounts” Pushed Back

If an account is identified as a “preexisting account,” a participating FFI need not apply new account-opening procedures to the account, which may be more onerous and also provide a shorter timeframe. Due to the delay in releasing the final Forms W-8 and instructions, the IRS will now allow FFIs or withholding agents to treat obligations that are issued before January 1, 2015 as preexisting for due diligence, withholding and reporting requirements under FATCA.

This change is available only for obligations held by entities, not by individuals, because the account procedures for individual accounts are less complex and the instructions were published in final form in March. This means that FFIs must implement new account-opening procedures sufficiently to determine which accounts are held by individuals and to capture the additional information required from those individuals.

This newly announced transition period and delay on new account-opening procedures do not affect other FATCA deadlines, such as the requirement to begin withholding on preexisting accounts.

### Corresponding Changes to IGAs

The Treasury intends to update the Annex I of future Model 1 and Model 2 IGAs to include new due diligence procedures for entity accounts opened on or after July 1, 2014 and before January 1, 2015 to allow an FFI covered by an IGA to treat those accounts as preexisting entity accounts. However, FFIs will not be allowed to apply the \$250,000 exception to those accounts. (Certain identification and documentation procedures are not required for a preexisting entity account with a value of \$250,000 or less in which no holder of that account has been previously documented as a U.S. person.)

If the jurisdiction has an existing IGA in force, the Notice allows the jurisdiction to adopt the revised due diligence procedures once another IGA with the revised procedures has been signed with another jurisdiction.

### Limited FFIs and Limited Branches

For any member of an expanded affiliated group to obtain status as a participating FFI or registered deemed-compliant FFI, each member of the group must be a participating FFI, deemed-compliant FFI, exempt beneficial owner or limited FFI. To be treated as a limited FFI, the FFI or branch must be registered with the IRS and agree to certain conditions. One condition is that the FFI or branch may not open accounts that are required to be treated as U.S. accounts or accounts held by nonparticipating FFIs, including accounts transferred from any member of its expanded affiliated group.

In some jurisdictions, local law would make compliance with this condition difficult, for example, when local law requires financial institutions to provide individual residents with access to banking services. Therefore, the Notice allows a limited FFI or limited branch to open U.S. accounts for residents of the jurisdiction provided that the limited FFI or limited branch does not solicit (1) U.S. accounts from persons not resident in the jurisdiction or (2) accounts held by nonparticipating FFIs that are not established in the jurisdiction. Also, the limited FFI or limited branch must not be used by another FFI in its expanded affiliated group.

In addition, some local laws prohibit an FFI from registering with the IRS as a limited FFI. If a law is preventing a limited FFI (a “*prohibited FFI*”) from registering with the IRS, the Notice now allows members of an expanded affiliated group to obtain a status as a participating FFI or registered deemed-compliant FFI as long as the prohibited FFI is identified on FATCA’s registration website by another member of the group. To do this, (a) the other member must (1) identify itself as a “Lead FI,” (2) confirm that the prohibited FFI made a representation that it would meet the conditions for limited FFI status, and (3) confirm that the prohibited FFI will notify the Lead FI within 30 days of the date that the FFI ceases to be a limited FFI, and (b) if the Lead FI receives notification or knows that the prohibited FFI can no longer comply, the Lead FI will update the information on the FATCA registration website within 90 days and will no longer be required to act as Lead FI.

This new rule will allow some extended affiliated groups flexibility in registering where local laws conflict with FATCA regulations.

### Reason to Know Standard

The temporary coordination regulations, which coordinate Chapter 3 withholding with FATCA withholding, will be amended to provide that a direct account holder will be considered documented before July 1, 2014 without regard to whether the withholding agent obtains renewal documentation for the account holder on or after July 1, 2014. Thus, a withholding agent would also not be required to apply new reason to know standards relating to a U.S. telephone number or U.S. place of birth until the withholding agent is notified of a change in circumstances with respect to the account holder’s foreign status.

The reason for the change stemmed from comments that stated that the transitional rule for preexisting obligations had limited use for withholding agents because it was tied to a withholding agent’s reliance on documentation obtained from an account holder prior to July 1, 2014. Therefore, without this update, the transitional rule would not have included cases in which a withholding agent renews a withholding certificate or documentary evidence on or after July 1, 2014.

## Reasonable Explanation of U.S. Indicia

Under certain conditions, a withholding agent (for Chapter 3 and FATCA withholding) may rely on the foreign status of an individual account holder irrespective of certain U.S. indicia if the account holder provides a reasonable explanation. A reasonable explanation may be either a written statement prepared by an individual or a checklist provided by a withholding agent stating that the individual meets the requirements.

Commentators have noted that the description of reasonable explanation in the final FATCA regulations differs from the description in the temporary coordination regulations. The IRS intends to amend the FATCA regulations to conform to the reasonable explanation description in the temporary coordination regulations, which would permit an individual to provide a reasonable explanation that is not limited to an explanation meeting the requirements of Treasury Regulation Section 1.1471-3(e)(4)(viii)(A) through (D).

## Key Terms

### FFI

Foreign financial institution. A financial institution is any entity that (1) accepts deposits in the ordinary course of a banking or similar business, (2) as a substantial portion of its business, holds financial assets for the account of others, or (3) is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting or trading in securities, partnership interests, commodities or any interest (including a futures or forward contract or option) in such securities, partnership interests or commodities. Thus, a financial institution would include a hedge fund, a private equity fund or other collective investment vehicle, as well as a bank. An insurance company will not be a financial institution for these purposes if the insurance company only sells property or casualty insurance or reinsurance contracts.

## Intergovernmental Agreements (IGA)

Agreement between the IRS and a taxing authority of another nation which allows automatic information exchanges of account holder information between governments. Generally, FFIs that are resident in a country with an effective IGA will report to their own government and not to the IRS.

### Withholdable Payment

A withholdable payment includes (1) any fixed, determinable annual or periodic payment (such as interest rents, royalties and dividends) if such payment is from sources within the United States and (2) any gross proceeds from the sale or other disposition of any property of a type that can produce interest or dividends from sources within the United States.

## For More Information

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