

E-ALERT | Financial Institutions & Tax

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NOTICE 2011-34 – NEW GUIDANCE ON FATCA REPORTING & WITHHOLDING REQUIREMENTS

On April 8, 2011, the U.S. Treasury Department and Internal Revenue Service (the “IRS”) issued a new round of guidance under the Foreign Account Tax Compliance Act (“FATCA”). Effective January 1, 2013, FATCA generally will impose a 30% withholding tax on foreign financial institutions (“FFIs”) that receive certain payments and income from U.S. sources unless the FFI enters into an agreement with the IRS. This “FFI Agreement” will require the FFI to (1) identify and report U.S. ownership of foreign accounts and assets, and (2) withhold on payments to non-compliant FFIs and non-compliant account holders. The IRS and Treasury are working on additional guidance under FATCA and have asked for comments on what types of guidance they should issue. The next round of comments is due by June 7, 2011, and interested stakeholders should consider submitting comments. This client alert summarizes some of the key points of the new guidance, Notice 2011-34.

Passthru Payments.

Notice 2011-34 explains how an FFI that enters into an FFI Agreement (a “participating FFI”) can comply with the requirement to withhold tax on U.S.-source payments, and other payments “attributable to” U.S.-source payments, when these amounts are paid by the FFI to non-compliant FFIs and non-compliant account holders. Payments passing through the FFI on their way to the non-compliant recipients are called “passthru payments” in the FATCA statute.

The notice takes the approach that the amount of the passthru payment subject to withholding cannot be traced back to the U.S. source payment received by the FFI. Instead, under the notice, a passthru payment attributable to U.S.-source income (and thereby subject to the 30% withholding tax) generally includes a portion of the payment corresponding to the ratio of the FFI’s gross U.S. assets to its gross worldwide assets.

Simplified Reporting.

Notice 2011-34 modestly relaxes some of the reporting requirements with respect to U.S.-owned accounts identified by the FFI. Under prior guidance, participating FFIs would have had to report the highest account value of their U.S.-owned accounts, as determined periodically throughout the year, and provide copies of monthly or quarterly account statements and daily receipts and withdrawals upon IRS demand. In response to a number of critical comments, Notice 2011-34 now provides that participating FFIs need to report only year-end account balances to the IRS, unless the account is an interest in an entity.

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FATCA requires participating FFIs to report gross receipts and gross withdrawals or payments from U.S. accounts, but prior guidance had not specified the frequency or manner of such reporting.

Under Notice 2011-34, an FFI will be required to report annually the gross amount of dividends, interest, proceeds from the sale or redemption of property, and other income paid or credited to each U.S. account. In many circumstances, the character of these amounts (i.e., capital or ordinary) can be determined under the laws of the FFI's home jurisdiction if done consistently. For U.S. accounts that are equity or debt interests in the FFI itself, a participating FFI must report annually the gross amount of all distributions, interest, redemption payments, and similar amounts.

Commenters noted that FFIs may face constraints under local law that would prevent consolidating account holder information across branches or affiliates located in different jurisdictions. Under the notice, each affiliated group of FFIs will have the option to report consolidated account holder information. Alternatively, the FFI may elect to report account holder information on a branch-by-branch basis if each branch elects to be subject to the same reporting obligations as U.S. financial institutions.

Pre-Existing Individual Accounts.

Previous guidance limited the initial due diligence required for the pre-existing individual accounts of a participating FFI to a review of "electronically searchable" information. Notice 2011-34 removes this limitation for the accounts of a participating FFI's private banking department and for all of the FFI's high-value accounts. For these preexisting accounts, an FFI will be required to conduct a diligent review of all account files for indicia of U.S. ownership.

Under the notice, participating FFIs with private banking departments must ensure that private banking relationship managers identify known U.S. accountholders and diligently review their client files and records for indicia of U.S. ownership. The relationship manager must identify each account holder (including associated family members) whose records bear indicia of U.S. ownership, and request documentation to determine if the account holder is a U.S. taxpayer during the first year after the FFI enters an FFI Agreement.

For all accounts with a balance or value of \$500,000 or more, the FFI must perform a diligent review and obtain identifying accountholder documentation for accounts with indicia of U.S. ownership, within two years after the FFI enters an FFI Agreement. Beginning in the third year, the FFI will be required to perform a diligent review of any accounts that would have exceeded the \$500,000 threshold if tested on the last day of the preceding year, but that did not exceed this account balance when originally tested.

Under the notice, each participating FFI will need to have its Chief Compliance Officer certify that these due diligence procedures have been followed. The CCO also must certify that the FFI has not engaged in any activity to assist U.S. account holders in avoiding FATCA.

Deemed-Compliant FFIs.

The Notice allows certain FFIs to achieve compliance with FATCA without entering into an FFI Agreement, subject to a certification that has to be performed every 3 years. FFIs potentially eligible for this status include certain local banks that implement procedures to prevent non-compliant taxpayers from opening or maintaining accounts, certain local banks with participating FFI affiliates that implement certain account identification and compliance procedures, and funds whose owners are FATCA-compliant and meet other FATCA-imposed requirements.

Expanded Affiliated Groups.

Under FATCA, reporting and withholding obligations apply on the basis of affiliated groups of FFIs. Notice 2011-34 clarifies that the affiliated group of FFIs will be required to undertake a coordinated application process through a “lead FFI” to become FATCA-compliant. Under this approach, all FFI affiliates will become participating FFIs or deemed-compliant FFIs and may designate an FFI affiliate to be the “compliance FFI” responsible for overseeing group compliance with FATCA.

The notice also contemplates permitting a centralized compliance option for collective investment entities (funds) associated with a common asset manager, under which the asset manager would execute a single FFI agreement on behalf of each member of the group. The notice contemplates that this option will be limited to scenarios where the asset manager is able to monitor and account for each fund’s compliance.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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