APRIL 2012

TREASURY ISSUES PROPOSED REGULATIONS ON THE INFORMATION REPORTING AND WITHHOLDING TAX PROVISIONS OF FATCA

I. INTRODUCTION

On February 8, 2012, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS") released proposed regulations (the "Proposed Regulations") implementing the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment Act enacted on March 18, 2010 ("HIRE"). Contemporaneously with the issuance of the Proposed Regulations, Treasury issued a joint statement with the governments of France, Germany, Italy, Spain, and the United Kingdom expressing their mutual intention to create an intergovernmental framework for implementing FATCA.

Congress enacted FATCA to combat tax evasion by U.S. persons holding investments in offshore accounts. FATCA seeks to accomplish this goal by requiring foreign financial institutions ("FFIs") and non-financial foreign entities ("NFFEs") to disclose information about their account holders and beneficial owners or face a mandatory 30 percent withholding tax on certain amounts payable to them. The FATCA rules sweep broadly, requiring compliance by many foreign institutions and entities, including banks, brokerages, investment funds, and insurance companies. FATCA also requires U.S. taxpayers to report information annually about their non-U.S. assets with values exceeding certain thresholds on IRS Form 8938, despite some overlap with reporting by taxpayers on interests in foreign financial accounts on Form TD F 90-22.1.

The Proposed Regulations provide detailed instructions on how U.S. withholding agents, FFIs, and NFFEs are to comply with FATCA. The Preamble to the Proposed Regulations (the "Preamble") expresses Treasury's intention to strike a balance between fulfilling the policy objectives of FATCA while minimizing the considerable burdens imposed by the new regime. To that end, the Preamble explains that the IRS is considering an alternative form of compliance whereby an FFI would report the required information to the government of its residence country, and that government would in turn supply the information to the United States pursuant to an income tax treaty, tax information exchange agreement, or other agreement.

The Proposed Regulations generally will become effective upon publication of final regulations. As discussed in greater detail below, the Preamble highlights eight principal features. Thus, the Proposed Regulations:

- Expand the scope of "grandfathered obligations" that are not subject to FATCA withholding to include any payment made under an obligation outstanding on January 1, 2013 (and any gross proceeds from the disposition of such an obligation);
- Delay full implementation until January 1, 2016 of the rule requiring all FFI members of an "expanded affiliated group" to comply with applicable reporting requirements;
- Expand the list of "deemed-compliant FFIs" that do not need to enter into "FFI agreements" in order to avoid FATCA withholding;
- Simplify the due diligence procedures applicable to a "participating FFI" in its identification of "U.S. accounts" to permit primary reliance on electronic review of many accounts;
- Explain how a participating FFI certifies its compliance with FATCA requirements;
- Narrow the definition of "financial account" to exclude certain accounts or interests, including debt and equity interests that are regularly traded on an established securities market; retirement accounts, pension accounts, and non-retirement savings accounts that meet certain requirements; certain term life insurance contracts; and certain accounts held solely by or on behalf of exempt beneficial owners;
- Delay information reporting on income and gross proceeds until 2016 (with respect to the 2015 calendar year) and 2017 (with respect to the 2016 calendar year), respectively; and
- Delay withholding on foreign "passthru payments" until at least 2017.

All "section" references in this White Paper are to the Internal Revenue Code of 1986, as amended (the "Code").

II. BACKGROUND ON FATCA

A. ISSUES AND POLICY GOALS

Prior to FATCA, the existing information reporting and withholding rules with respect to payments of U.S.-source investment income, as applied to FFIs, were difficult to enforce, especially where those FFIs had no other connection to the United States. Where FFIs acted as intermediaries between withholding agents and their account holders (as the beneficial owners of those payments), they were generally required to provide the withholding agents with specific documentation establishing each account holder's exemption from withholding or eligibility for a reduced withholding rate (such as an IRS Form W-8 or W-9). However, if an FFI entered into a reporting and withholding agreement with the IRS as a "qualified intermediary," the FFI generally was not required to provide the specific documentation to the withholding agent that it would otherwise have to, as long as it could determine for itself and certify that the account holder was exempt or otherwise eligible for a reduced rate of tax (based on the specific documentation it received from the account holder).

FATCA is an attempt to prevent, in particular, the abuse of these rules by U.S. persons seeking to evade tax on U.S.-source investment income through the use of accounts with financial institutions located abroad, principally in tax havens, and to increase transparency with respect to reporting and withholding involving other types of foreign entities.

B. STATUTE

The FATCA provisions of HIRE added a new Chapter 4 to the Code, which includes new sections 1471, 1472, 1473, and 1474. New sections 1471 and 1472 are the principal operative FATCA provisions, while new sections 1473 and 1474 provide additional definitions and certain special ancillary rules, respectively.

C. IRS NOTICES

Prior to the issuance of the Proposed Regulations, the IRS issued three items of preliminary guidance on FATCA: Notice 2010-60, Notice 2011-34, and Notice 2011-53 (collectively, the "Notices"). The Notices offered limited guidance in several areas, including the new withholding requirements, due diligence procedures, and key implementation dates, but left many questions unanswered.

D. PROPOSED REGULATIONS

The Proposed Regulations are intended to guide taxpayers as to the implementation of FATCA's information reporting and withholding requirements. They are very detailed, spanning several hundred pages and introducing an array of new definitions and concepts to the Code. (An appendix containing many of these definitions is included at the end of this White Paper.) While the Proposed Regulations incorporate and largely build upon the guidance supplied in the Notices, they diverge from the Notices in certain respects, largely in response to concerns raised by taxpayers.

Additional guidance is also forthcoming. Treasury expects to release a draft model FFI agreement in the first half of 2012, which it anticipates finalizing before the end of the year.

E. INTERGOVERNMENTAL JOINT STATEMENT

Critics of FATCA have been numerous, including a number of foreign governments that, while generally supportive of the underlying goals of FATCA, are unhappy with the means chosen to achieve them. Decried as overly burdensome and costly to implement, many view FATCA as an attempt by the United States to apply its laws extraterritorially, possibly requiring foreign institutions to violate the domestic laws of their home countries.

To that end, and coinciding with the issuance of the Proposed Regulations, Treasury announced that it had reached an agreement with France, Germany, Italy, Spain, and the U.K. to explore a "common approach" to FATCA compliance through domestic reporting and reciprocal automatic exchange of information pursuant to bilateral treaties. How this approach will bear out remains to be seen, although potentially it could provide an avenue for certain foreign institutions—likely those based in countries in which the risk of tax evasion by U.S. persons is relatively low—to be deemed compliant with FATCA without following all of the law's technical requirements.

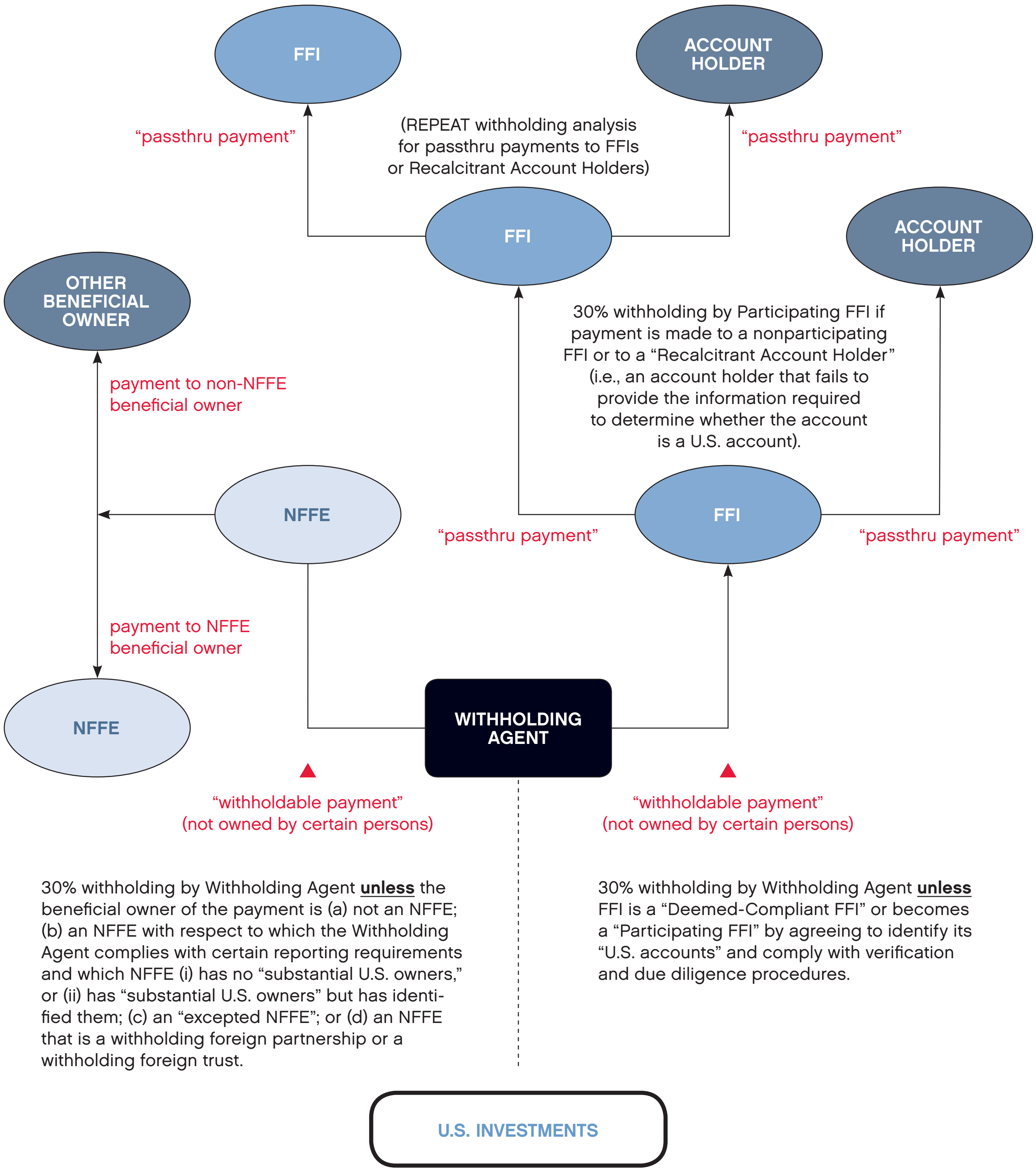
III. HOW FATCA WORKS

A. THE FRAMEWORK

FATCA operates by implementing a diligence and reporting regime under which (i) FFIs must enter into agreements with the IRS to report information about their U.S. account holders, as well as information about income and principal payments made with respect to those holders' accounts, and (ii) NFFEs must report certain information about substantial U.S. owners or certify that there are none.

Subject to exceptions, a withholding agent is required to withhold 30 percent of "withholdable payments" paid to an FFI or NFFE that does not comply with these requirements. Treasury and the IRS have made clear that the threat of withholding is intended to promote compliance rather than generate revenue.

FATCA WITHHOLDING



B. WITHHOLDING AGENT DUTIES

1. Definition of "Withholding Agent"

A "withholding agent" is any person, U.S. or foreign, acting in whatever capacity, having control or custody of, in receipt of, or disposing or making payment of, a withholdable payment. For example, a U.S. corporation paying a dividend to shareholders or interest on a debt obligation is a withholding agent with respect to such payments. Essentially, any person touching a withholdable payment may become a withholding agent with respect thereto, and several persons may be treated as withholding agents with respect to the same payment. A withholding agent that fails to withhold upon a payment that is subject to withholding may be liable for any tax not properly withheld.

The original payor of a withholdable payment is likely to be a U.S. person, and any such withholding agent must determine whether and to what extent it must withhold on payments made to an FFI or NFFE under the operative FATCA provisions of sections 1471 and 1472, respectively. In the hands of a "participating FFI," the withholdable payment is generally treated as a "passthru payment," with respect to which the FFI becomes the withholding agent on further remittances by the FFI of the withholdable payment to other payees.

2. Withholdable Payments, Payees, and Withholding Agent Duties

"Withholdable payments" generally include any payments of (i) U.S.-source interest, dividends, rents, salaries, wages, premiums, annuities, and other fixed or determinable annual or periodic ("FDAP") income, or (ii) gross proceeds from the sale or other disposition of property that can produce U.S.-source interest or dividends. The "payee" of any such withholdable payment is usually the entity receiving the withholdable payment unless an exception applies under the Proposed Regulations (generally related to specific situations in which the withholding agent treats the FFI or NFFE as an intermediary). Once the withholding agent has determined (i) that it is making a withholdable payment and (ii) the appropriate payee of that withholdable payment, the withholding agent must collect documentation with respect to such payee, regardless of whether the appropriate payee is the recipient FFI or NFFE or another person.

In the event an FFI is the payee, a withholding agent generally must withhold 30 percent of withholdable payments made to that FFI if the withholding agent has not received documentation showing that such FFI has complied with its FATCA reporting and diligence requirements. However, if the recipient FFI is not the payee, a withholding agent must collect documentation with respect to the appropriate payee in addition to documentation from the FFI.

Likewise, in the event an NFFE is the payee, a withholding agent also must generally withhold 30 percent of withholdable payments made to that NFFE if the withholding agent has not received documentation as to the NFFE's substantial U.S. owners. However, if a withholding agent is not entitled to treat the recipient NFFE as the payee, the withholding agent must collect documentation as to the substantial U.S. owners of the relevant payee. Note, however, that these general withholding agent duties are in each case subject to certain exceptions, discussed in greater detail below.

A withholding agent's duty to collect documentation is intended to allow the proper determination of an FFI's, NFFE's, or other payee's status for FATCA purposes and, accordingly, whether payments are subject to withholding. A withholding agent may treat an FFI payee as a "participating" or "registered deemed-compliant" FFI, and thereby avoid withholding on payments to them, if the FFI has provided a valid withholding certificate and the withholding agent has annually verified the FFI's employer identification number ("EIN") on the IRS's published FFI list (separate requirements apply to "certified deemed-compliant" FFIs). For payments made on or after January 1, 2017, the withholding certificate must include the FFI's EIN; however, for withholdable payments made with respect to preexisting accounts prior to January 1, 2017, the withholding agent may accept a withholding certificate with the EIN omitted as long as the withholding agent separately obtains (either orally or in writing) and verifies the FFI's EIN.

A withholding agent making a payment to an NFFE is subject to similar rules, but without the EIN-verification requirement, in determining the status of the relevant payee. In the absence of adequate documentation, a withholding agent may make certain presumptions regarding a payee's status based on certain indicia of the payee's likely individual or entity status, or U.S. or foreign status. The focus, ultimately, is

(i) on the beneficial owner of a payment governed by section 1472, whether it is the NFFE that directly receives the payment or an NFFE for whom the payment is received, and (ii) whether that beneficial owner has substantial U.S. owners.

C. FFI REGIME

1. Key Concepts

- To avoid withholding under FATCA, FFIs that are not "deemed compliant" must enter into agreements with the IRS ("FFI agreements") in order to be considered "participating FFIs."
- FFI agreements mandate that participating FFIs identify account holders, conduct due diligence and reporting, withhold on payments as required, and adopt written policies and procedures on FATCA compliance. Such procedures require affected FFIs to, *inter alia*, conduct periodic internal reviews and provide the IRS with periodic certifications of compliance, including certifications by responsible officers with respect to preexisting accounts.
- Accounts with balances below certain thresholds are exempt from review or are subject to more limited review.

2. FATCA Compliance

In order to avoid withholding under FATCA, an FFI must either (i) conclude an FFI agreement and comply with the obligations of its FFI agreement (a "participating FFI") or (ii) be treated as compliant with FATCA by virtue of certain characteristics, even absent an FFI agreement and its attendant obligations (a "deemed-compliant FFI"). In addition, subject to certain exceptions, an FFI's status as participating or deemed compliant depends on whether each member of an FFI's expanded affiliated group also meets certain requirements.

a. *Participating FFI*

As noted, a participating FFI is obligated, both by the terms of its FFI agreement with the IRS and the Proposed Regulations, to fulfill numerous reporting, withholding, and diligence requirements, among others. The details of these requirements are discussed at length in the following section.

COMMENT

Although the Proposed Regulations provide clarity as to a participating FFI's obligations under FATCA, the anticipated burdens of compliance—in the absence of clear guidance—affected the lending market considerably following FATCA's enactment. As FFIs, lending institutions feared that compliance might be (or eventually become) impracticable. As withholding agents, borrowers hoped to escape any obligation to gross lenders up for taxes required to be withheld under FATCA. While term loans negotiated in the two years following FATCA's enactment were expected, as of enactment, to be grandfathered (with a new reprieve through the end of 2012), agreements that contained a revolver or similar mechanism posed FATCA issues from the outset.

b. *Deemed-Compliant FFI*

Deemed-compliant FFIs are those institutions regarded by the IRS as presenting a low risk of tax evasion and therefore treated as compliant with FATCA's requirements. A deemed-compliant FFI may be either "registered" or "certified" and will be exempt from withholding requirements under section 1471, as well as outside the scope of section 1472 (applicable to NFFEs).

A registered deemed-compliant FFI generally falls within one of the following classes: local FFIs, nonreporting members of participating FFI groups, qualified investment vehicles, restricted funds, and FFIs in compliance with section 1471(b) based on an agreement between a foreign government and the United States. Any such FFI must review its accounts, register with the IRS regarding its status, certify that it meets the requirements of its applicable deemed-compliant category, agree to the conditions of its deemed-compliant status, and renew its certification every three years unless a change in circumstance necessitates earlier renewal.

A certified deemed-compliant FFI is outside the scope of FATCA altogether and generally falls within one of the following classes: nonregistering local banks, retirement plans, nonprofit organizations, and FFIs with only low-value accounts. A certified deemed-compliant FFI is required only to attest to the withholding agent that it meets the requirements of its certified deemed-compliant category via IRS Form W-8.

c. *Expanded Affiliated Group Compliance*

Except as otherwise provided by IRS guidance, in order for an FFI to be treated as participating or deemed compliant, each member of such FFI's expanded affiliated group must also be treated as participating or deemed compliant. Thus, the participation or deemed compliance of each member of an expanded affiliated group may be a condition precedent of the participation or deemed compliance of each other member of that group.

3. FFI Agreement & Requirements of a Participating FFI

A participating FFI is an FFI with respect to which an FFI agreement is effective. The IRS expects to publish a model FFI agreement later this year in a Revenue Procedure setting forth an FFI's requirements under section 1471(b) and (c). Any such agreement is expected to include, at a minimum, each of the obligations discussed below.

a. *Identify U.S. Accounts*

In order to implement FATCA's policy goals, it is critical that participating FFIs diligently identify accounts held by U.S. persons or entities with one or more substantial U.S. owners ("U.S. accounts"). For this purpose, a substantial U.S. owner is, very generally, a U.S. person owning, directly or indirectly, more than 10 percent of an entity's interests. The identification of U.S. accounts must comport with certain due diligence procedures in order to exempt participating FFIs from a strict liability standard with respect to accounts not properly reported and amounts not properly withheld.

The Proposed Regulations modify prior diligence requirements, outlined under the Notices, in order to reduce compliance burdens and target accounts posing the greatest concern to the IRS. Accordingly, accounts with balances exceeding $1 million are subject to heightened diligence procedures, while preexisting individual and entity accounts (i.e., existing as of the effective date of the operative FFI agreement) with balances not exceeding $50,000 and $250,000, respectively, are exempt altogether. As a general matter, due diligence requirements are intended to facilitate an FFI's identification of certain indicia the IRS believes may suggest a potential U.S. account in order determine whether the FFI maintains any U.S. accounts.

U.S. INDICIA

The following factors suggest that an account may be a U.S. account:

- Identification of the account holder as a U.S. resident or citizen
- U.S. place of birth
- U.S. resident address or U.S. mailing address (including a U.S. post office box)
- U.S. telephone number
- Standing instructions to transfer funds to an account maintained in the United States
- Power of attorney or signatory authority granted to a person with a U.S. address
- An "in-care-of" address or "hold mail" address in the United States that is the sole address the FFI has identified for the account holder

Diligence requirements are distinct with respect to new and preexisting accounts held by both entities and individuals, and they are discussed in greater detail in Part IV of this White Paper. In connection with an FFI's diligence obligations, a participating FFI must adopt written policies governing and memorializing its diligence procedures.

In addition, within one year of an FFI agreement's effective date, a responsible officer of the participating FFI must certify that, to the best of such officer's knowledge after conducting a reasonable inquiry, the FFI did not have any formal or informal practices in place to assist account holders in avoiding any account's designation as a high-value account (generally, an account with a balance in excess of $1 million) or otherwise evading FATCA. Within two years of an FFI agreement's effective date, an officer must certify that the FFI has completed the account identification procedures and requirements necessary under FATCA or is otherwise in compliance with its FFI agreement. Periodically following an FFI agreement's effective date, a participating FFI must conduct reviews of its compliance with FATCA, and a responsible officer of the FFI must certify to the IRS as to such compliance, including the disclosure of material compliance failures.

b. *Report on U.S. Accounts*

Participating FFIs must annually report to the IRS with respect to all accounts treated as U.S. accounts. Reporting obligations will be phased in for U.S. accounts maintained by participating FFIs in 2013, 2014, and 2015.

For U.S. accounts maintained in 2013 and 2014, a participating FFI is required to report the following information:

- The name, address, and taxpayer identification number ("TIN") of each holder that is a specified U.S. person;
- The account number; and
- The account balance or value.

For U.S. accounts maintained in 2015, a participating FFI must report:

- The name, address, and TIN of each holder that is a specified U.S. person;
- The account number;
- The account balance or value; and
- The payments made with respect to the account during the calendar year.

For U.S. accounts maintained in 2016 and subsequent years, a participating FFI must report:

- The name, address, and TIN of each holder that is a specified U.S. person;
- The account number;
- The account balance or value;
- The payments made with respect to the account during the calendar year; and
- Other information required by the form published by the IRS used to facilitate such reporting.

With respect to an account held by a U.S.-owned foreign entity, a participating FFI must report:

- The name, address, and TIN (if any) of the U.S.-owned foreign entity;
- The name, address, and TIN of each substantial U.S. owner of such entity;
- The account number;
- The account balance or value; and
- The payments made with respect to the account during the calendar year.

Unless a participating FFI's branch reports separately, the foregoing information must also include the jurisdiction of the FFI's branch maintaining each such account. In lieu of such reporting, a participating FFI may elect to report on IRS Form 1099 as if such FFI were itself a U.S. person and each relevant payee were an individual citizen of the United States, subject to certain modifications.

Each FFI agreement will also obligate the participating FFI to comply with IRS and Treasury requests, if any, for additional information regarding any U.S. account maintained by the FFI.

COMMENT

In addition to the required reporting on U.S. accounts, the Proposed Regulations provide special rules for reporting by FFI branches and U.S. payors, as well as rules for reporting with respect to accounts held by FFIs organized in U.S. territories and accounts maintained for certain other FFIs. Moreover, each participating FFI is subject to separate reporting obligations with respect to accounts held by "recalcitrant account holders" and with respect to "passthru payments." The Proposed Regulations also reserve sections for reporting requirements of qualified intermediaries, withholding foreign partnerships, and withholding foreign trusts.

In the event that, absent a waiver, foreign law would preclude an FFI from reporting the information required by its FFI agreement, the FFI must obtain a valid and effective waiver from an account holder (or substantial U.S. owner of an entity account holder) such that the FFI may report the necessary information. If such a waiver cannot be obtained within a reasonable period of time, the participating FFI must close the account.

COMMENT

Many FFIs have objected to FATCA on the grounds that compliance with these reporting requirements contravenes local law, and such objections are the genesis (at least in part) of the intergovernmental joint statement discussed above. The construct outlined in the statement comports with prior suggestions for information exchange provided by the OECD and evidences IRS intent to make FATCA practicable for affected entities.

c. *Withhold on Certain Payments*

An FFI agreement effectively renders a participating FFI a withholding agent with respect to withholdable payments it receives and subsequently pays to account holders (i.e., passthru payments that are withholdable payments). Although a U.S. withholding agent should not be required to withhold upon payments made to any participating FFI, the participating FFI itself is generally required to deduct and withhold tax equal to 30 percent of any passthru payment that is a withholdable payment made after December 31, 2013 to a recalcitrant account holder, nonparticipating FFI, or participating FFI electing to be withheld upon under section 1471(b)(3), absent an exception. Additional guidance regarding withholding obligations in respect of foreign passthru payments is reserved in the Proposed Regulations, but withholding for such payments will begin no earlier than January 1, 2017.

4. Effective Dates

Aspects of FATCA are effective at different times. The following timeline highlights key dates leading up to full FATCA implementation in 2017.

FATCA TIMELINE OF KEY DATES

2012

FEBRUARY 8, 2012
Treasury and the IRS issue Proposed Regulations on FATCA.

2013

JANUARY 1, 2013
Obligations issued on or after this date are no longer "grandfathered."

FFIs may begin submitting FFI applications to the IRS.

JUNE 30, 2013
FFIs must sign FFI agreements by this date to be considered participating FFIs effective as of January 1, 2014.

2014

JANUARY 1, 2014
Withholding begins on withholdable payments of U.S. source FDAP income.

JUNE 30, 2014
Due diligence and responsible officer certification requirements must be completed for preexisting, high-value accounts (for FFI agreements effective June 30, 2013).

SEPTEMBER 30, 2014
FATCA reports to IRS from FFIs are due for calendar year 2013, providing limited information on U.S. accounts such as identifying information and account balances.

2015

JANUARY 1, 2015
Withholding begins on withholdable payments of gross proceeds from the disposition of property that can produce U.S.-source dividends and interest.

MARCH 31, 2015
FATCA reports to IRS from FFIs are due for calendar year 2014, providing limited information on U.S. accounts such as identifying information and account balances.

JUNE 30, 2015
Due diligence and responsible officer certification requirements must be completed for all preexisting accounts (for FFI agreements effective June 30, 2013).

2016

JANUARY 1, 2016
Transitional period for affiliates with legal prohibitions on compliance ends.

MARCH 31, 2016
FATCA reports to IRS from FFIs are due for calendar year 2015, including information required in prior reports as well information on income associated with U.S. accounts.

2017

JANUARY 1, 2017
Earliest date on which withholding on foreign passthru payments begins.

MARCH 31, 2017
FATCA reports to IRS from FFIs are due for calendar year 2016, including information required in prior reports as well information on gross proceeds from certain transactions. Full FATCA reporting now required.

5. Exceptions

In addition to those FFIs deemed compliant with FATCA, notable exceptions to some or all of the requirements imposed by section 1471 include the following:

a. *Grandfathered Obligations*

As discussed in greater detail in Part IV of this White Paper, FATCA does not apply to payments made under, or gross proceeds from the disposition of, obligations outstanding on January 1, 2013. For this purpose, an "obligation" is generally defined as a legal agreement that produces or could produce a withholdable payment or a passthru payment, with certain exceptions. The Proposed Regulations provide detailed guidance as to the classification of grandfathered obligations, including when an obligation ceases to be grandfathered.

b. *Exempt Payees*

Various portions of the Proposed Regulations and FATCA's statutory language eliminate a withholding agent's obligation to withhold on payments made to certain entities, as well as payments beneficially owned by certain classes of persons. Section 1471(f) exempts any payment beneficially owned by:

- Any foreign government, any political subdivision thereof, or any wholly owned agency or instrumentality of one or more of the foregoing;
- Any international organization or wholly owned agency or instrumentality thereof; and
- Any foreign central bank of issue.

The Proposed Regulations also eliminate withholding on payments beneficially owned by certain retirement funds and entities wholly owned by exempt beneficial owners. Moreover, withholding agents need not withhold on payments to participating or deemed-compliant FFIs, nor must they withhold on payments to "excepted FFIs," defined by the Proposed Regulations to include:

- Certain nonfinancial holding companies;
- Certain startup companies;
- Certain nonfinancial entities in liquidation or bankruptcy;
- Hedging or financing centers of nonfinancial groups; and
- Section 501(c) organizations.

D. NFFE REGIME

1. Key Concepts

- A withholding agent must withhold 30 percent of any withholdable payment to an NFFE if the payment is beneficially owned by the NFFE or another NFFE, unless certain requirements are met.
- Withholding does not apply to payments beneficially owned by certain classes of persons identified in Treasury guidance or regulations, or to any class of payments identified by Treasury as posing a low risk of tax evasion.

2. NFFE Requirements

As with FFIs, FATCA includes a withholding and reporting regime for NFFEs. Subject to exceptions, an NFFE is any foreign entity that is not an FFI. A withholding agent must withhold 30 percent of any withholdable payment to an NFFE if the payment is beneficially owned by the NFFE or another NFFE ("NFFE Withholding") unless certain requirements are met. The following chart summarizes the requirements for avoiding NFFE Withholding.

REQUIREMENTS TO AVOID NFFE WITHHOLDING

(i) The beneficial owner or payee must provide the withholding agent with either:

(A) a certification that such beneficial owner does not have any substantial U.S. owners, or

(B) the name, address and TIN of each substantial U.S. owner;

(ii) the withholding agent must not know or have reason to know that any information provided by the beneficial owner or payee is incorrect; **and**

(iii) the withholding agent must report the information provided to the IRS.

COMMENT

The implicit corollary to the rule set forth in section 1472 is that where a payment is not beneficially owned by an NFFE, notwithstanding that the initial recipient is an NFFE acting as an intermediary, NFFE Withholding should not apply. However, the Proposed Regulations lack specific guidance as to a payment made to an NFFE that is beneficially owned by an FFI. Technically, this payment does not fall within the ambit of *section 1472; nonetheless, the withholding regimes of sections 1471 and 1472 are not necessarily mutually exclusive. The Proposed Regulations provide coordination rules for FFIs making payments to NFFEs, but not the inverse. One would expect, however, that even if the initial withholding agent is not obligated to withhold under section 1472, the recipient NFFE then becomes the withholding agent for purposes of section 1471, and the payment is withheld upon at the second tier.*

NFFE Withholding does not apply to payments beneficially owned by certain classes of persons identified in Treasury guidance or regulations, or to any class of payments identified by Treasury as posing a low risk of tax evasion. Entities specifically excluded from NFFE Withholding are:

i. Any corporation the stock of which is regularly traded on an established securities market, as well members of such corporation's expanded affiliated group;
ii. Any entity that is organized under the laws of a possession of the United States and that is wholly owned by one or more bona fide residents of such possession;
iii. Any foreign government, political subdivision of a foreign government, or wholly owned agency or instrumentality of any one or more of the foregoing;
iv. Any international organization or any wholly owned agency or instrumentality thereof;
v. Any foreign central bank of issue;
vi. Any government of a U.S. possession;
vii. Certain retirement funds;
viii. Any FFI that is engaged (or holds itself out as engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, notional principal contracts, insurance or annuity contracts, or any interest in such investment products, and that is wholly owned by one or more entities described in (iii) – (vii) above;
ix. Any NFFE if less than 50 percent of its gross income for the preceding calendar year is passive income [or] less than 50 percent of its assets held at any time during the preceding calendar year are assets that produce or are held for the production of passive income. (Note that the IRS has indicated this is supposed to be a conjunctive rather than disjunctive test, and the "or" indicated above in brackets will be corrected to "and" shortly.);
x. Excepted FFIs, which are certain nonfinancial holding companies, certain start-up companies, nonfinancial entities that are liquidating or emerging from reorganization or bankruptcy, hedging/financing centers of a nonfinancial group, and section 501(c) entities; and
xi. Withholding foreign partnerships or withholding foreign trusts that have concluded withholding agreements with the IRS.

To determine whether a withholdable payment is subject to NFFE Withholding, a withholding agent must first identify the beneficial owner of the payment. In general, a withholding agent should treat the recipient of a payment as the beneficial owner unless the withholding agent is entitled to treat the recipient as an agent or intermediary. In determining the recipient's status, a withholding agent can treat a payment as made to one of the exempt payees noted in (i) – (ix) above if the withholding agent can reliably associate the payment with valid documentation regarding such status. Payments made to other classes of persons are subject to the same identification rules, as well as the same set of presumptions applicable to payments that cannot be reliably associated with valid documentation, that apply with respect to FFIs.

A withholding agent must annually complete IRS Form 1042-S with respect to each recipient, reporting all amounts paid to that recipient in each calendar year. A withholding agent must also file an annual information return on IRS Form 1042 reporting the aggregate amount of all items reflected on each IRS Form 1042-S. A withholding agent in receipt of information regarding any substantial U.S. owners of a payee NFFE that is not described in (i) – (xi) above must report the following information regarding such owner(s) to the IRS on or before March 15 of the calendar year following the year in which a withholdable payment is made:

- The name of the NFFE that is owned by any substantial U.S. owner;
- The name of each such owner;
- Each such owner's TIN;
- The mailing address for each such owner; and
- Any other information as required by the designated form for reporting and its accompanying instructions.

E. SECTION 6038D REPORTING

New section 6038D was added to the Code by HIRE in 2010 and requires certain persons to disclose information about their foreign financial assets on IRS Form 8938. Although the requirement to disclose interests is effective for tax years beginning after March 18, 2010, IRS Notice 2011-55 suspended the obligation to attach this form to a taxpayer's federal income tax return until publication of a final version of IRS Form 8938. Any forms for which the obligation to file was deferred pursuant to this Notice must be attached to tax returns filed after finalization of IRS Form 8938. The IRS finalized IRS Form 8938 on December 15, 2011 and issued temporary regulations on section 6038D (the "Temporary Regulations") a few days later.

Section 6038D requires "specified persons" holding an interest in one or more "specified foreign financial assets" ("SFFAs") at any time during a taxable year to complete and attach IRS Form 8938 to the individual's tax return for that year if the aggregate value of such assets exceeds certain dollar thresholds. At present, a "specified individual" means a U.S. citizen, a U.S. resident, a nonresident alien who has elected to be taxed as a U.S. resident, and a bona fide resident of Puerto Rico (or certain other U.S. possessions). However, future regulations may provide that a specified person also includes a domestic entity.

The dollar thresholds that trigger reporting under section 6038D are increased for married persons filing jointly and individuals living abroad as follows:

REPORTING THRESHOLDS

Filing Status	Residence	Aggregate Value of Specified Foreign Financial Assets	
		On last day of Taxable Year	***At any time during Taxable Year***
Single *(or Married Persons Filing Separately)*	U.S.	$50,000	$75,000
Married Filing Jointly	U.S.	$100,000	$150,000
Single *(or Married Persons Filing Separately)*	Outside U.S.	$200,000	$300,000
Married Filing Jointly	Outside U.S.	$400,000	$600,000

An SFFA generally includes any financial account maintained by an FFI, including those maintained by a financial institution that is organized under the laws of a U.S. possession. An FFI includes investment vehicles such as foreign mutual funds, foreign hedge funds, and foreign private equity funds. However, financial accounts maintained by a U.S. payor (including accounts held in a foreign branch of a U.S. financial institution or the U.S. branch of an FFI) and financial accounts for which the mark-to-market rules of the Code are followed are excluded from this definition.

An SFFA also includes certain other assets that are held for investment (rather than in connection with the conduct of a trade or business) and not held in an account maintained by an FFI, including:

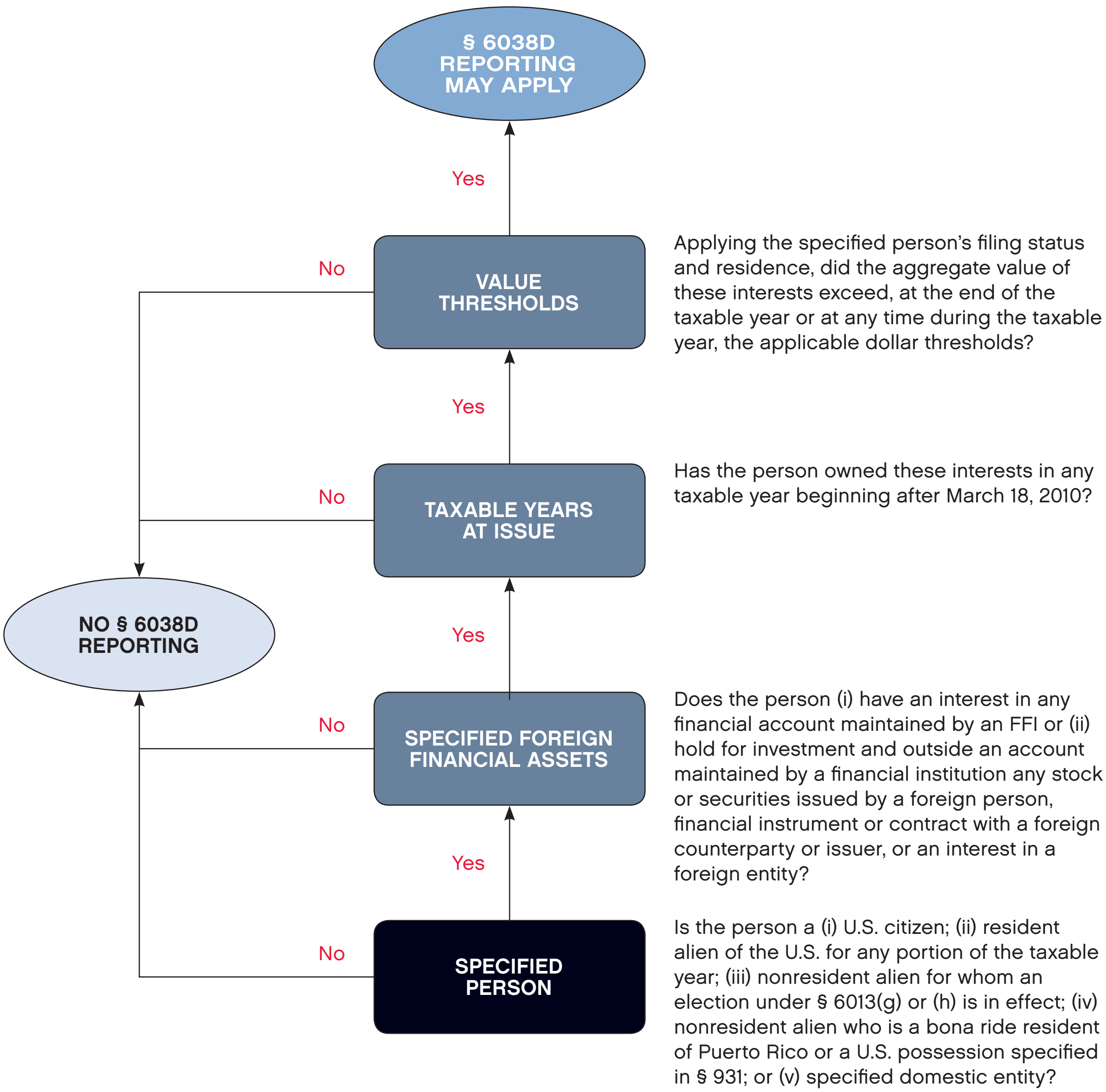
- Stock or securities issued by a person other than a U.S. person;
- A financial instrument or contract that has an issuer or counterparty other than a U.S. person, such as (i) a note, bond, debenture, or other form of indebtedness, (ii) an interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar

arrangement, and (iii) any option or other derivative instrument with respect to any of the foregoing examples or with respect to any currency or commodity;

- An interest in a foreign entity, such as a capital or profits interest in a foreign partnership, or an interest in a foreign trust or estate if the specified person knows or has reason to know (based on readily accessible information) of the interest;
- An interest in a foreign pension plan or foreign deferred compensation plan (although an interest in a social security, social insurance, or other similar plan of a foreign government is excluded); and
- Potentially stock options, restricted stock units, and other equity compensation awards granted by non-U.S. issuers.

A person has an "interest" in an SFFA if any income, gains, losses, deductions, credits, gross proceeds, or distributions attributable to the holding or disposition of the SFFA are or would be required to be reported, included, or otherwise reflected by the specified person on an annual return (even if no such amounts or items are attributable to the holding or disposition of the SFFA for the taxable year).

SECTION 6038D REPORTING



A taxpayer is required to report, with respect to each SFFA, the maximum value of that asset during the tax year. Taxpayers will not be required to obtain appraisals of assets that do not have an easily established fair market value, as the Temporary Regulations generally permit taxpayers to use a reasonable estimate of the asset's maximum fair market value. Taxpayers also may rely upon periodic account statements (provided at least annually) to determine a financial account's maximum value, unless the taxpayer has actual knowledge or reason to know, based on readily accessible information, that the statements do not reflect a reasonable estimate of the maximum account value during the taxable year. For valuation purposes, assets denominated in a foreign currency during a taxable year must be valued in the foreign currency and then converted to U.S. dollars.

Amounts reported on certain other income tax forms need not be reported on IRS Form 8938. Significantly, however, Form TD F 90-22.1 ("Report of Foreign Bank and Financial Accounts," or "FBAR") is not among them. Form TD F 90-22.1 is required in connection with the reporting of interests in foreign financial accounts. It is important to note that section 6038D reporting operates independently of FBAR reporting. While the information reported on each form overlaps to some extent, the requirements of each form can differ. For instance:

- The dollar threshold for FBAR reporting is $10,000 at any time during the calendar year. The dollar threshold for reporting on IRS Form 8938 is as low as $50,000 for single persons resident in the U.S.
- FBAR reporting can be required for persons with mere signature authority over (but no financial interest in) foreign financial accounts, as well as for persons with legal but not beneficial ownership of accounts. Reporting on IRS Form 8938 is required only for persons for whom items of income, loss, and so on from holding or disposing of an account or asset would need to be reflected on the person's income tax return.
- Form TD F 90-22.1 reporting does not apply, at present, to interests in foreign hedge funds or private equity funds. Interests in these funds must be reported on IRS Form 8938.
- Form TD F 90-22.1 is due on June 30 of each year following the year for which reporting is required. IRS Form 8938 is filed with a specified person's tax return.

IV. HIGHLIGHTS OF THE PROPOSED REGULATIONS

In the intervening months between FATCA's enactment and the issuance of the Proposed Regulations, Treasury and the IRS used the Notices to define the scope and operation of FATCA, as well as solicit feedback on FATCA's potential contours. Accordingly, the Proposed Regulations modify, clarify, and expand upon the Notices in several ways. Although the actual number of departures from, and additions to, guidance provided in the Notices is considerable, the Preamble highlights the following eight changes.

A. EXPANDED SCOPE OF GRANDFATHERED OBLIGATIONS

The Proposed Regulations extend the grandfather period from March 18, 2012 to January 1, 2013. Therefore, payments on, and proceeds from, the disposition of obligations outstanding on January 1, 2013 are exempt from FATCA withholding. An "obligation" is defined for this purpose as "any legal agreement that produces or could produce a passthru payment," including debt instruments (such as bonds), revolving credit facilities, and derivative transactions entered into under an ISDA Agreement. The term "obligation" does not include interests treated as equity, instruments without a stated term or expiration (e.g., savings or demand deposits), brokerage agreements, custodial agreements, or other similar agreements to hold financial assets for the account of others.

An obligation is considered to be "outstanding" on January 1, 2013 (i) if it has an issue date, for U.S. tax purposes, before January 1, 2013, or (ii) in the case of an obligation not constituting indebtedness for U.S. tax purposes, if a legally binding agreement establishing the obligation was executed before January 1, 2013.

COMMENT

Note that because the rule for obligations constituting indebtedness relies on the issue date of the obligations, an issuance of notes that occurs after the end of the grandfather period can still be covered by the grandfather rule if the notes are issued as part of a "qualified reopening" of grandfathered notes for U.S. federal income tax purposes. An issuance of publicly traded debt instruments can be "reopened" *under the Code, and additional notes issued, either within six months of the original issue date of the instruments or if certain other conditions are met. If a reopening qualifies under these rules, the new, additional instruments are treated as part of the original issuance, and both sets of debt instruments are treated as having the same issue date, the same issue price, and (with respect to holders) the same adjusted price for tax purposes. The additional instruments can also be issued with the same CUSIP number as the original instruments, and the instruments are therefore considered fungible. In light of the grandfather rule, many issuers will want—to the extent possible—to treat an issuance occurring on or after January 1, 2013 as a qualified reopening of a pre-2013 issuance such that the issuance will not only be fungible with the original notes, but will also be free from the burdens of FATCA.*

Conversely, obligations issued during the grandfather period are not entirely in the clear. If the terms of a grandfathered obligation are altered after the end of the grandfather period in a manner that constitutes a "significant modification" for U.S. federal income tax purposes (e.g., if there is a change in the obligor of a recourse obligation, there is a more than a de minimis *change in yield, there are certain changes in the timing of payments, etc.), the obligation is deemed for tax purposes to be exchanged for a "new" obligation. This new obligation would have a new issue date for tax purposes and therefore would not have been "outstanding" during the grandfather period. The obligation therefore would become subject to FATCA.*

B. TRANSITIONAL RULE FOR AFFILIATES WITH LEGAL PROHIBITIONS ON COMPLIANCE

In order for an FFI to be treated as participating or deemed compliant, each member of such FFI's expanded affiliated group generally must be treated as either participating or deemed compliant. This rule presents a dilemma for affiliates in jurisdictions with laws prohibiting compliance. The Proposed Regulations attempt to resolve this problem by providing a two-year transitional period; prior to January 1, 2016, if an FFI's expanded affiliated group includes an FFI located in a jurisdiction with prohibitions on compliance, the existence of the noncompliant affiliate will not prevent the other members of the group from being treated as participating or deemed-compliant FFIs, as long as the noncompliant affiliate agrees to perform the due diligence required of participating FFIs for identifying U.S. accounts, to retain the account holder documentation it collects, and to report, to the extent permitted under relevant law, on accounts that it is required to treat as U.S. accounts.

Similar rules apply when a branch of an FFI is located in a jurisdiction with laws prohibiting compliance. Whether a particular office is a "branch" depends on how that office is treated under the laws of the country in which it is located. Prior to January 1, 2016, an FFI that otherwise satisfies the requirements for participating FFI status will be considered a participating FFI as long as the FFI maintains at least one branch that can comply with the FFI agreement (even if that branch is in the United States) and each branch of the FFI agrees to perform the due diligence required of participating FFIs for identifying U.S. accounts, to retain the account holder documentation it collects, and to report, to the extent permitted under relevant law, on accounts that it is required to treat as U.S. accounts.

COMMENT

It is important to note that these noncompliant affiliates and branches must identify themselves to withholding agents as nonparticipating FFIs and will still be subject to FATCA withholding. Further, the transition rule does not itself solve the problem that these noncompliant affiliates may continue to operate in jurisdictions with laws prohibiting compliance with FATCA. The Preamble notes that Treasury and the IRS expect to consult with foreign governments as to whether those governments will amend their jurisdictions' laws to allow compliance with FATCA, or to propose alternative approaches to implementing FATCA's reporting regime (e.g., by allowing an FFI to report information to the foreign government in its jurisdiction of residence, as long as the foreign government subsequently shares that information with the IRS as contemplated by the intergovernmental statement described above). If, however, Treasury and the IRS cannot—prior to the end of the transition period—finalize arrangements with the foreign governments of all jurisdictions that currently prohibit compliance, then the existence of a noncompliant affiliate in one of these jurisdictions may prevent the rest of the group members from being treated as participating or deemed-compliant FFIs.

C. ADDITIONAL CATEGORIES OF DEEMED-COMPLIANT FFIs

Notice 2011-34 provided that entities within certain classes of institutions would be deemed compliant with section 1471(b). The categories provided in this Notice included certain local banks, local FFI members of participating FFI groups, certain investment vehicles, and certain foreign retirement plans. The Proposed Regulations employ and augment the categories outlined in Notice 2011-34, extending deemed compliance to, *inter alia*, qualified nonprofit organizations, certain categories of FFIs (e.g., certain owner-documented FFIs and those maintaining only low-value accounts), and expanded categories of investment funds and foreign retirement plans. The classification of deemed-compliant FFIs is further refined by the division of deemed-compliant FFIs into two classes—registered and certified—both of which are discussed in greater detail in Part III.C of this White Paper. In addition, the Proposed Regulations increase the potential number of entities qualifying as a "local bank" identified in Notice 2011-34 by explicitly treating each European Union Member State as "local" vis-à-vis each other Member State for this purpose.

D. MODIFICATION OF DUE DILIGENCE PROCEDURES FOR THE IDENTIFICATION OF ACCOUNTS

Participating FFIs must identify their U.S. accounts using prescribed procedures. The Proposed Regulations ease the due diligence procedures outlined in the Notices, often permitting electronic review of preexisting accounts and the use of existing intake procedures to review new accounts. The Proposed Regulations also relax previous diligence requirements by exempting a wider range of accounts from diligence altogether. An FFI's due diligence obligation (if any) with respect to each of its accounts turns on two variables: (i) whether the account is new or preexisting and (ii) whether the account is held by an individual or an entity.

1. Preexisting Individual Accounts

The Proposed Regulations create three tiers of review for preexisting individual accounts: no review, limited review, and enhanced review. Any preexisting individual account with a value of $50,000 or less on the effective date of the operative FFI agreement is exempt from diligence requirements for so long as the account balance or value does not exceed $1 million at the end of any subsequent calendar year. To the extent the FFI or its affiliates allow aggregation of accounts held by the same individual, the aggregate balance must not exceed either threshold in order to achieve and maintain exempt status. The exemption also applies to certain preexisting cash value insurance or annuity contracts held by individuals with balances of $250,000 or less.

Preexisting individual accounts that are not exempt are subject to either limited or enhanced review in order to identify U.S. indicia with respect to each such account. Limited review applies to those accounts with values in excess of $50,000 ($250,000 in the case of certain cash value insurance or annuity contracts) but not in excess of $1 million; such accounts are subject only to the electronic review of searchable data.

Enhanced diligence procedures apply to accounts with values in excess of $1 million; diligence with respect to such accounts involves manual review of the "customer master file" and related documents, but only to the extent information containing U.S. indicia is not available in the FFI's searchable electronic databases. As a result, manual review of non-electronic (i.e., paper) files is only required if the FFI's electronic files contain insufficient information about the account holder. In addition, enhanced review entails an inquiry with the relationship manager of any affected account to determine whether he or she has actual knowledge that the account holder is a U.S. person. If the FFI identifies any U.S. indicia with respect to an individual account, it must obtain documentation necessary to establish whether the account is in fact a U.S. account.

2. Preexisting Entity Accounts

A participating FFI is exempt from due diligence procedures with respect to any preexisting entity account with a value of $250,000 or less as of the effective date of the operative FFI agreement. This exemption is effective until such time as the value exceeds $1 million. To the extent the FFI or its affiliates allow aggregation of accounts held by the same entity, the aggregate balance must not exceed either threshold in order to achieve and maintain exempt status.

Nonexempt preexisting entity accounts are generally subject to electronic review of records obtained in connection with existing "anti-money laundering" and "know your customer"

("AML/KYC") diligence requirements in order to identify U.S. accounts. However, in the event a "passive investment entity" (i.e., an NFFE that is not an "excepted NFFE") has an account balance exceeding $1 million, the FFI maintaining such account cannot rely solely on AML/KYC records and must obtain information regarding all substantial U.S. owners or a certification that there are none.

COMMENT

Diligence requirements for preexisting accounts are modified under the Proposed Regulations to allow for primarily electronic review of information, an increased de minimis *threshold for exempted accounts, and greater reliance on AML/KYC procedures; such changes, including the abandonment of the private banking account requirements outlined in Notice 2011-34, are generally responsive to industry concerns about the burdens imposed by FATCA.*

DILIGENCE REQUIREMENTS

Type of Owner	Account Balance or Value as of Effective Date of FFI Agreement	Applicable Level of Diligence	Change in Applicable Level of Diligence
Entity	≤ $250,000	Exempt	No longer exempt when balance > $1,000,000
Entity	$250,000 < and ≤ $1,000,000	Limited Review	Increased review above $1,000,000 if owner is a passive investment entity
Passive Investment Entity	> $1,000,000	Enhanced Review	None
Individual	≤ $50,000	Exempt	No longer exempt when balance > $1,000,000
Individual	$50,000 < and ≤ $1,000,000	Limited Review	Increased review above $1,000,000
Individual	> $1,000,000	Enhanced Review	None
Individual *(certain cash value insurance or annuity contracts)*	≤ $250,000	Exempt	No longer exempt when balance > $1,000,000
Individual *(certain cash value insurance or annuity contracts)*	$250,000 < and ≤ $1,000,000	Limited Review	Increased review above $1,000,000
Individual *(certain cash value insurance or annuity contracts)*	> $1,000,000	Enhanced Review	None

3. New Individual Accounts

New individual accounts generally require the FFI's review of all information collected under its general intake procedures in order to flag any U.S. indicia, allowing FFIs to rely extensively on existing practices with respect to new accounts. If the FFI identifies U.S. indicia in connection with an account's opening, it must collect additional documentation in order to determine the account's status. If the account is required to be treated as a U.S. account, the FFI must collect IRS Form W-9 and a valid and effective waiver of foreign law (generally regarding that jurisdiction's privacy laws), if necessary, within one year of the effective date of the FFI agreement. Failure to obtain the required documentation requires the FFI to identify the account as held by a recalcitrant account holder.

4. New Entity Accounts

FFIs will generally be required to determine whether an entity opening a new account has substantial U.S. owners; the Proposed Regulations contemplate that such a determination will often be made via certification from the account holder unless the entity is otherwise exempt from documenting its substantial U.S. owners.

For all accounts, whether preexisting or new and regardless of the type of owner, an FFI may generally rely on documentation collected pursuant to its diligence procedures or otherwise maintained in its files unless the FFI knows or has reason to know the documentation is not valid and reliable or until a change in circumstances affects an account holder's status under these rules.

E. PROCEDURES TO VERIFY COMPLIANCE

FFIs must comply with any verification procedures promulgated by the IRS regarding the identification of U.S. accounts, and each FFI agreement will contain its own procedures for verification. However, each FFI agreement must, at a minimum, require the participating FFI to (i) adopt written policies and procedures governing the participating FFI's compliance with its responsibilities under the FFI agreement; (ii) conduct periodic internal reviews of its compliance; and (iii) periodically provide the IRS with a certification of its compliance and other limited information. The required certification must be provided by a responsible FFI officer who attests that the FFI has complied with the terms of its FFI agreement. Any FFI in compliance with the verification requirements of the Proposed Regulations and the terms of its FFI agreement will not be held strictly liable for failing to identify a U.S. account. However, repeated or systematic failures to comply with an FFI agreement may result in the imposition of heightened verification requirements on a case-by-case basis. In extreme cases, the IRS may appoint an external auditor to verify an FFI's compliance.

F. REFINEMENT OF THE DEFINITION OF FINANCIAL ACCOUNT

Pursuant to FATCA's statutory language, the term "financial account" means any depository account, any custodial account, and any equity or debt interest in an FFI, other than interests that are regularly traded on an established securities market. This definition is narrowed by the Proposed Regulations in order to focus on accounts posing the most concern to the IRS—in particular, traditional bank, brokerage, and money market accounts, together with interests in investment vehicles. The Proposed Regulations provide detail regarding which accounts are treated as depository and custodial accounts and include guidance with respect to insurance and annuity contracts. Notably, the Proposed Regulations provide a number of exclusions from the classes of financial account captured by section 1471, including certain savings accounts, accounts held or beneficially owned by exempt beneficial owners, and most debt and equity securities issued by banks and brokerage firms. For purposes of identifying excluded interests, the Proposed Regulations contain detailed guidance for determining which interests constitute applicable debt or equity, when such interests are treated as regularly traded on an established securities market, and when anti-abuse rules apply.

G. EXTENSION OF THE TRANSITION PERIOD FOR THE SCOPE OF INFORMATION REPORTING

FATCA requires participating FFIs to report the name, address, TIN, and year-end account balance of, and payments (both income and gross proceeds) made with respect to, all U.S. accounts. In response to requests for additional time to make system adjustments necessary for information reporting under FATCA, the Proposed Regulations phase in FFI reporting obligations over time.

For 2014 and 2015, participating FFIs are required to report only the name, address, TIN, account number, and account balance with respect to U.S. accounts. Beginning in 2016, reporting is also required with respect to income paid to U.S. accounts. Beginning in 2017, reporting will include gross proceeds paid to U.S. accounts. In addition, while prior guidance contemplated that account information would necessarily be reported in U.S. dollars, the Proposed Regulations allow FFIs to report in the currency in which the account is maintained.

H. PASSTHRU PAYMENTS

FATCA obligates a participating FFI to comply, with respect to any passthru payment, with withholding requirements similar to those imposed on the initial withholding agent of a withholdable payment. The Proposed Regulations define a "passthru payment" as (i) any withholdable payment or (ii) any "foreign passthru payment" (the definition of which is still forthcoming). Participating FFIs are required to withhold 30 percent of any passthru payments made to nonparticipating FFIs and recalcitrant account holders; however, only passthru payments that are withholdable payments are subject to this requirement through at least December 31, 2016. With respect to foreign passthru payments, the IRS has, for the moment, abandoned a method described in prior guidance that would require an FFI to calculate the ratio of the value of its U.S. assets to the aggregate value of all of its assets in order to determine the extent of withholding on foreign passthru payments.

An FFI's obligation with respect to passthru payments is intended to prevent a nonparticipating FFI from using a participating FFI as an investment intermediary to avoid the reach of FATCA. Participating FFIs are required to withhold on passthru payments that are withholdable payments beginning in 2014 and will also be required to withhold on passthru payments that are foreign passthru payments beginning no sooner than the start of 2017 (a two-year extension of the 2015 date previously indicated in Notice 2011-53). However, in order to reduce incentives for nonparticipating FFIs to use participating FFIs to avoid FATCA withholding and reporting during that time, the Proposed Regulations will require a participating FFI to report payments of "foreign reportable amounts" made to nonparticipating FFIs in 2015 and 2016. The term "foreign reportable amounts" is defined as (i) FDAP income that would be a withholdable payment if paid by a U.S. person and (ii) "other financial payments" (another forthcoming definition). Meanwhile, the Preamble expresses Treasury's commitment to work with the governments of other jurisdictions to develop practical alternatives to passthru payment withholding.

LAWYER CONTACTS

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APPENDIX OF DEFINITIONS

Deemed-compliant FFI: An FFI that is treated as compliant with its obligations under FATCA—notwithstanding the absence of an FFI agreement—and thus exempt from withholding under FATCA.

Exempt beneficial owner: A person with respect to which withholdable payments are not subject to withholding under FATCA, provided that such person is the beneficial owner of such payments.

Foreign financial institution (FFI): Broadly defined as any financial institution that is a foreign entity.

FFI agreement: An agreement between an FFI and the IRS whereby the FFI agrees to abide by its obligations under section 1471(b) and (c), as well as any other obligations specified in the agreement.

Financial account: Any depository or custodial account maintained by a financial institution and any equity or debt interest in a financial institution, other than interests regularly traded on an established securities market or subject to other exceptions under the Proposed Regulations. Certain cash value insurance contracts and annuity contracts issued or maintained by a financial institution are also included. The term is intended to focus on traditional bank, brokerage, and money market accounts and interests in investment vehicles; most debt and equity securities issued by banks and brokerage firms are excluded.

Financial institution: Any entity that (i) accepts deposits in the ordinary course of a banking or similar business, (ii) holds financial assets for the account of others as a substantial portion of its business, (iii) is engaged or purports to be engaged primarily in the business of investing or trading in securities, partnership interests, commodities, or related interests, or (iv) is a specified insurance company.

Grandfathered obligation: An obligation outstanding on January 1, 2013.

Non-financial foreign entity (NFFE): Any foreign entity that is not an FFI.

Obligation: For purposes of identifying a grandfathered obligation, an "obligation" is a legal agreement that produces or could produce a withholdable payment or passthru payment, other than an instrument that is treated as equity for U.S. tax purposes or that lacks a stated expiration or term.

Participating FFI: An FFI with respect to which an FFI agreement is in full force and effect.

Passthru payment: Any withholdable payment and any foreign passthru payment. The phrase "passthru payment that is a withholdable payment" generally refers to a payment—in the hands of an FFI—that was a withholdable payment in the hands of the initial withholding agent. The definition of "foreign passthru payment" is pending.

Recalcitrant account holder: A holder of an account maintained by a participating FFI if the holder is not itself an FFI and the holder fails to comply with the participating FFI's request for information or documentation (including IRS Form W-9 and an effective waiver of foreign law).

Specified U.S. person: Any U.S. person unless specifically excepted by the Proposed Regulations (e.g., certain trusts and government entities).

Substantial U.S. owner: A specified U.S. person that owns, directly or indirectly, more than 10 percent of the stock of a corporation, or with respect to a partnership, more than 10 percent of the profit interests or capital interests in such partnership; the term also includes a U.S. person that holds, directly or indirectly, more than 10 percent of the value of the beneficial interests in a trust or a U.S. person that is an owner of a grantor trust.

U.S. account: Any financial account held by one or more specified U.S. persons or foreign entities with substantial U.S. owners.

Withholdable payment: Interest, dividends, rents, salaries, wages, premiums, annuities, and other fixed or determinable annual or periodic (FDAP) income from sources within the U.S. and the gross proceeds from the sale or other disposition of any property that may produce interest or dividends from sources within the U.S. (e.g., stock or debt obligations).

Withholding agent: Any person, U.S. or foreign, acting in whatever capacity, having control or custody of, in receipt of, or disposing or making payment of, a withholdable payment.