

FATCA and FBARs:

What Non-Financial Foreign Entities (and their U.S. Affiliates) Need to Know

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FATCA: Current State of Play

- Proposed FATCA regulations issued Feb. 2012; final regs. expected later this year
- Announcement 2012-42 extended timelines for some due diligence / other requirements
- Many countries are negotiating Intergovernmental Agreements (IGAs) with U.S. (so far only U.K. & Denmark have signed, to be implemented in 2013)
- Some draft reporting forms, but lack of guidance

Proposed Implementation Timeline

- Registration of FFIs (period opens) Jan. 1, 2013
- Grandfathered obligations Jan. 1, 2013
- Withholding: FDAP / portfolio income Jan. 1, 2014
- Reporting: substantial U.S. owners (NFFE) Mar. 15, 2014
- Reporting: account and balance Sep. 30, 2014
- Req. to document status of payees Dec. 31, 2015
 - With respect to preexisting obligations
- FFI affiliated group requirement Jan. 1, 2016
- Reporting: income Mar. 31, 2016
- Withholding: gross proceeds Jan. 1, 2017
- Withholding: passthru payments Jan. 1, 2017
- Reporting: gross proceeds Mar. 31, 2017
 - Proceeds from broker transactions



Review of FATCA Provisions

- Use of a threat of 30% withholding on payments to foreign financial institutions (“FFI”) and nonfinancial foreign entities (“NFFE”) to force those foreign entities to adopt information reporting with respect to U.S. owned accounts (FFI) and Substantial U.S. Owners (NFFE)
- Aimed at identifying U.S. tax account holders and entity owners

Review of FATCA Impacts on NFFEs and MNCs that do Business with Them

- Impacts on U.S. “withholding agents” (payors)
 - Requirement to determine type of payee (foreign vs. domestic; FFI vs. NFFE)
 - Must characterize types of payments to determine whether they are “withholdable payments” (and if so whether an exception applies)
 - If withholding applies determine and document whether payee is FATCA compliant and/or exempt from withholding
 - Secondary liability for failure to withhold if foreign entity is noncompliant
- Impacts to foreign affiliates who are NFFEs (e.g. passive companies that are not affiliated with a publicly traded company)
 - Determine whether exception applies to NFFE or whether required to report the NFFE’s U.S. owners
 - If no exceptions apply, must disclose U.S. ownership or risk being withheld upon
- Impacts on “Substantial U.S. Owners” (>10% vote or value) of NFFEs (their interests in NFFE reported to IRS under FATCA)

Review of FATCA Provisions

- New Code § 1471 – Foreign Financial Institutions (**FFI**)
 - 30% withholding on “withholdable payments” made to FFIs who do not enter into a “Section 1471 Agreement”, and that are not deemed-compliant or that are not specifically excluded from the withholding requirement
 - FFI – banks, brokerage house, funds, ETFs, etc. (excludes holding companies and start-ups)
- New Code § 1472 – Nonfinancial Foreign Entity (**NFFE**)
 - 30% withholding on withholdable payments to NFFE unless NFFE provides withholding agent w/certification no Substantial U.S. Owners or provides information regarding each Substantial U.S. Owner to payor
 - Exceptions from definition of NFFE for publicly traded entity and “active NFFEs”
 - Exceptions to reporting requirements regarding substantial U.S. Owners that are publicly traded, bank, REIT or RIC

Review of FATCA Provisions

- Withholdable payments –
 - FDAP (fixed, determinable, annual and periodic) – includes U.S. source interest, dividends, some OID, rents, royalties
 - Proceeds from sale of interest or dividend-producing property from U.S. sources (beginning Jan. 1, 2017)
- Substantial U.S. owner – Reg. § 1.958-1 attribution rules apply
 - U.S. person who is >10% owner of corporate stock (vote or value)
 - U.S. person who is >10% owner of partnership profits or capital interests
- Section 1472 reporting requirement with respect to U.S. substantial owners (to avoid being withheld upon)
 - Name
 - Address
 - TIN
 - Or, certification NFFE has no substantial U.S. owners

Review of FATCA Provisions

- Exception to withholding when NFFE is:
 - Active NFFEs (<50% of gross income from passive sources and less than 50% of assets are those that produce passive income)
 - Publicly traded (and members of affiliated group)
 - Nonfinancial holding company
- Exceptions to NFFE reporting requirement when substantial U.S. owner is:
 - Publicly traded corporation or member of expanded affiliated group of publicly traded corp. (50% ownership threshold)
 - U.S. government or political subdivision
 - U.S. agency
 - Bank
 - Individual retirement plan
 - Most tax-exempt organizations
 - REIT
 - RIC
- Exceptions to definition of withholdable payment (see Step #3 FATCA for MNCs)

FATCA for U.S. MNCs

- U.S. corporation is a withholding agent for purposes of Chapter 4 and therefore must comply w/FATCA to the extent the U.S. corp. makes a “withholdable payment” to any FFI / NFFE
- Step #1: Identify payee / payee status regarding withholdable payment
 - Determine whether payee is U.S. or foreign (presumption foreign)
 - Determine whether FFI or NFFE (and whether exceptions apply for publicly traded or active NFFE)
 - If FFI, whether participating (valid withholding certificate) or nonparticipating
 - Documentation requirements to establish payee status (to determine whether withholding applies under § 1471 or 1472)
- Step #2: Identify potential withholdable payments
 - FDAP payments made after Dec. 31, 2013
 - Proceeds from sale of dividend or interest producing property paid after Dec. 31, 2016

FATCA for U.S. MNCs

- Step #3: Determine whether exception to Withholdable Payment applies (payments not treated as withholdable payments and payments to deemed compliant FFI and with respect to exempt beneficial owners)
 - Payments made in the “ordinary course” of business for nonfinancial services, goods, and the use of property not a withholdable payment
 - ❖ No special documentation requirements, but may want to maintain some record internally
 - Interest payments on OID on short-term obligations (183 days or less) – important exception applicable to most commercial paper
 - Effectively connected income that is not exempt under a treaty Permanent Establishment provision (i.e., U.S. taxes apply)
 - Interest on outstanding accounts payable with respect to nonfinancial goods, services and tangible property
 - Gross proceeds from sale of property that produces FDAP income that is excluded from the definition of withholdable payment (i.e., above exceptions)

FATCA for U.S. MNCs

- Step #4: If NFFE (no exceptions apply) and withholding applies, determine whether exceptions to reporting of substantial U.S. owners apply (publicly traded, REIT, RIC, etc.)
 - Obligation on withholding agent to determine payee status
- Step #5: If withholding applies, comply with reporting requirements
 - Collect and validate information from NFFE re substantial U.S. owners
 - Report same to IRS
- Step #6: Obligation to withhold on payment if NFFE refuses to provide information on substantial U.S. owners
 - Absent an exception, must withhold on FDAP income paid after Dec. 31, 2013 (regardless of whether payee is beneficial owner or intermediary) and proceeds paid after Dec. 31, 2016
- Even if exception applies and withholding not required, need to document why withholding not done (i.e., “ordinary course” exception to withholdable payment)

FATCA for U.S. MNCs

■ Examples of When FATCA Kicks In:

- U.S. biotech company pays a privately held Israeli company royalty payments for licensing a medical device patent
 - ❖ Royalty payments = FDAP
 - ❖ If Israeli company is an NFFE, needs to certify no substantial U.S. owners or identify them
 - ❖ If “ordinary course” payments, excepted from withholding
 - ❖ If not, withholding applies unless Israeli company is an “active NFFE”
- Dividend payments to nonpublicly traded foreign insurance company that is not an FFI
 - ❖ Model IGAs confirm that insurance companies that do not issue cash value life insurance or annuity contracts (e.g., property and casualty) are NFFEs (and not FFIs)
 - ❖ Non-regularly traded insurance companies may be treated as “passive” NFFEs subject to due diligence / reporting requirements
 - ❖ Investment income earned on capital or reserves is passive and may meet the 50% or more passive income test to be treated as a passive NFFE



FATCA for U.S. MNCs

- MNCs that have foreign financial institutions within their organization may be subject to the more onerous FFI rules
 - Offshore investment treasury centers that invest in securities other than in hedging transactions
 - Offshore “deposit taking institutions” for third party customers
 - Special securitization vehicles as a means to float debt

Proposed Regulations

- Withholding
 - Jan. 1, 2014 – w/h required on income payments (originally 2013)
 - Jan. 1, 2017 – w/h requirements expanded to include gross proceeds
 - ❖ From sale of property that generates U.S. source interest or dividends
 - Jan. 1, 2017 – Earliest date to apply w/h on passthru payments (pending further guidance)
- Reporting – to be phased in gradually between 2014 and 2017
 - Mar. 15, 2014: begin reporting on substantial U.S. owners
 - 2014 – 2015: required to report name, address, TIN, account number and account balance on U.S. accounts.
 - 2016: FFIs required to report income based on 2015 calendar year
 - 2017: reporting to include gross proceeds



Proposed Regulations

- Expanded scope of “grandfathered obligations”
 - Exclude from definition of withholdable payment / passthru payment any payment made under an obligation outstanding on Jan. 1, 2013 (previously Mar. 18, 2012)
 - ❖ Applies to non-equity instruments with stated expiration or term
 - ❖ Still subject to FFI due diligence and reporting requirements

International Cooperation

- Alternate “governmental agreement” approach to FFI reporting
- Feb. 2012 Joint statement from U.S., Italy, Spain, Germany, France and United Kingdom regarding intergovernmental approach to improving international tax compliance and FATCA implementation
- Reiterates FATCA policy (appropriate information reporting and general commitment to combating international tax evasion)
- U.S. negotiating FATCA IGAs with numerous countries
 - May see country-specific provisions that complicate compliance for MNCs
- U.S. and partner country would enter into agreement to:
 - Pursue necessary implementing legislation to require local FFIs to collect and report required information to local tax authority;
 - Enable FFIs in partner countries to apply necessary diligence to identify U.S. accounts; and
 - Transfer to U.S., on an automatic basis, information provided by FFIs

International Cooperation

- In turn, U.S. agrees to:
 - Eliminate requirement for FFIs to enter into separate FFI agreements provided the FFI is registered w / IRS or exception applies
 - Allow FFIs to meet reporting obligations by reporting to partner country tax authority instead of IRS directly
 - Eliminate U.S. FATCA withholding on payments to FFIs in partner country (all participating FFIs or deemed compliant)
 - Commit to reciprocity with respect to auto-reporting to partner country tax authority (U.S. willingness to collect and exchange information regarding accounts held in US financial institutions)
- Model I agreement – reciprocal information exchanges where FFIs submit account owner information to home country tax authority
- Model II agreement – FFI reports directly to IRS (Japan & Switzerland)

FATCA Challenges

- Due diligence and documentation requirements for MNCs with foreign payees
 - Even if exception applies to definition of NFFE or withholdable payment, may still want to document basis for exception
- Centralized control over tax functions for MNCs to be FATCA compliant
- Impact of IGAs and country-specific entities and products carved out of FATCA
 - Reporting infrastructure – develop systems capable of identifying country-specific reporting requirements regarding affiliates in several countries
- Need to inventory non-U.S. joint ventures and related entities
 - Determine ownership (and whether exception to NFFE applies)
 - ID nonexempt NFFEs and take steps to make them FATCA compliant

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Created under Currency and Foreign Transaction Reporting Act of 1970 (Bank Secrecy Act) 31 U.S.C. § 5311 *et seq.*
- BSA intended to combat tax evasion, money laundering and terrorist financing
- Financial Crimes Enforcement Network (“FinCEN”) empowered to establish recordkeeping and filing requirements
- FinCEN delegated enforcement to IRS in 2003
- Final regulations issued Feb. 24, 2011 – 31 C.F.R. § 1010.350
- Each U.S. person having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country are required to file FBAR for each year interest or authority exists if aggregate value of all such accounts exceeded the \$10,000 filing threshold at any time during tax year

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Reportable accounts
 - Bank, custodial and securities accounts at foreign financial institutions and foreign branches of U.S. financial institutions
 - Indirect interests in foreign financial assets held by controlled entity (>50% interest)
 - Foreign mutual funds and foreign issued cash-value insurance contracts
 - Foreign pension funds
- Don't report
 - Accounts at U.S. branches of foreign financial institutions
 - Domestic mutual funds and foreign assets not in an account
 - Private equity and hedge funds (currently)
- Five-year record keeping requirement (from due date of FBAR)
- FinCEN has no expectation employees with only signature authority over employer's financial accounts will keep supporting information

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- FBAR reporting – procedures
 - Ensure using latest version of FBAR form (Jan 2012)
 - Filed on calendar years basis; due June 30 of following year – no extensions (no “mailbox” rule)
 - ❖ Note June 30, 2013 falls on Sunday, so real received by due date is June 28, 2013 for tax year 2012
 - Electronic filing encouraged (mandatory after June 30, 2013)
 - Report maximum value of each account during year
 - Convert to USD using year-end exchange rates

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

■ Special reporting rules:

- Consolidated reporting – U.S. entity that owns, directly or indirectly, > 50% interest in other entities that are required to file FBARs is permitted to file a consolidated report on behalf of itself and subsidiaries
- 25 or more foreign financial accounts – abbreviated filing to include basic information, but must provide detailed account information if requested by IRS
- Participants and beneficiaries in retirement plans under §§ 401(a), 403(a) or 403(b) are not required to file FBAR with respect to foreign financial accounts held by or on behalf of the retirement plan or IRA

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Who must report – U.S. Person & “Financial Interest”
 - Individuals
 - Legal entities (corporation, partnership, LLC, trust, estate, etc.)
 - Legal entities not subject to income tax are considered a separate person for FBAR purposes (single-member LLC / DRE)
 - U.S. person that owns, directly or indirectly, >50% of voting power or value of corporation that owns foreign financial account
 - U.S. person that owns, directly or indirectly, > 50% interest in profits or capital of partnership that owns foreign financial account
 - U.S. person that owns, directly or indirectly, >50% of voting power or value of other entity that owns foreign financial account
 - U.S. person with an agent, nominee or attorney acting on behalf of the U.S. person that owns foreign financial account
- Redundant reporting is intended

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Signature or other authority – authority (alone or in conjunction with others) to control the disposition of money, funds or assets held in the account by direct communication (written or otherwise)
- Regulatory exceptions to reporting – when U.S. person has no financial interest but **signature authority only**
 - Officer or employee of bank that is examined by Office of comptroller of the Currency, Board of Governors of Federal Reserve System, FCIC, Office of Thrift Supervision or National Credit Union Administration
 - Officer or employee of financial institution registered with SEC or CFTC
 - Officer or employee of Authorized Service Provider with respect to accounts owned or maintained by investment company that is registered with the SEC

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Regulatory exceptions to reporting – **signature authority only**
 - Officer or employee of entity with class of equities (or ADRs) listed on U.S. national securities exchange is not required to report signature authority over financial accounts of employer
 - Officer or employee of U.S. subsidiary of U.S. parent is not required to report signature authority over account owned by sub if parent has class of equities listed on U.S. national securities exchange and U.S. sub is included on U.S. parent's consolidated FBAR
 - Officer or employee of entity with class of equity (or ADRs) registered under section 12(g) of Securities Exchange Act not required to report signature authority over account of such entity
- What isn't included in the exceptions?
 - Officer of parent with signature authority over account owned by sub
 - Officer of sub with signature authority over account owned by parent, non-U.S. sub or sister entity
- Administrative deferral may have applied to 2011 and prior years

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Administrative deferral from reporting requirement

FBAR Deadline	Who Qualifies?	Which FBARs?	Guidance
6/30/13	(1) Officer or employee of publicly traded entity and registred financial institutions who has signature or other authority over and no financial interest in foreign financial account of a controlled person of the entity	Calendar Year 2011 and prior years	FinCEN Notice 2012-1
	(2) Officer or employee of controlled person of a publicly traded entity or registred financial institution who has signature or other authority over and no financial interest in foreign financial account of the entity, the controlled person or another controlled person of the entity		

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Form 8938 used to report **specified foreign financial assets** if the total value of all such assets in which taxpayer has an interest exceeds the applicable reporting threshold
- Form 8938 attached to annual income tax return and must be filed by due date (including extensions)
- Who must report:
 - **Specified person** that has an interest in specified foreign financial assets if the value is more than the applicable reporting threshold
 - ❖ Specified individuals (U.S. citizen, resident alien, etc.)
 - ❖ **Specified domestic entities (to extent provided in future regulations) – if formed or availed of to hold specified foreign financial assets and the value of such assets exceeds the reporting threshold - proposed regulations proposed effective / applicability date – tax years beginning after December 31, 2011**
- Reporting threshold – more than \$50,000 on last day of tax year or more than \$75,000 at any time during the tax year

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Specified foreign financial assets (broader than FBAR reporting)
 - Financial accounts maintained by foreign financial institution (FFI)
 - ❖ Depository or custodial accounts
 - ❖ Debt or equity interest in FFI other than those traded on an established securities market
 - Foreign financial institution
 - ❖ Accepts deposits in ordinary course of a banking or similar business
 - ❖ Holds financial assets for the account of others as a substantial part of its business
 - ❖ Engaged (or holds itself out as being engaged) primarily in business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interests (including futures or options) in such securities, partnership interests, or commodities
 - ❖ Includes investment vehicles such as foreign mutual funds, foreign hedge funds, foreign private equity funds

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Specified foreign financial assets (cont.)
 - Financial assets held for investment and not held in an account maintained by a FFI
 - ❖ Stock or securities issued by non-U.S. person
 - ❖ Interest in foreign entity
 - ❖ Financial instrument or contract that has an issuer or counterparty that is not a U.S. person
 - Examples
 - ❖ Stock in foreign corporation
 - ❖ Capital or profits interest in a foreign partnership
 - ❖ Note, bond, debenture or other form of indebtedness issued by foreign person
 - ❖ Interest rate swap, currency swap, basis swap, interest rate cap / floor, commodity swap, equity swap, equity index swap, credit default swap or similar agreement with a foreign counterparty
 - ❖ Option or other derivative instrument with respect to any of the above examples that is entered into with a foreign counterparty or issuer

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Specified foreign financial assets (cont.)
 - Asset is held for investment if not used or held for use in conduct of any trade or business
- Interest in specified foreign financial asset
 - Income, gains, losses, deductions, credits, gross proceeds or distributions from holding or disposing of the assets are or would be reportable on income tax return
 - Includes assets described above even if no actual items of income, gain, loss or deduction on the current year income tax return
- Owner of disregarded entity (DRE) has interest in any specified foreign financial assets owned by DRE



Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Specified foreign financial assets – valuation rules
 - Must determine the total value of all specified foreign financial assets in which taxpayer has an interest to determine if reporting threshold is satisfied
 - Value = fair market value of assets
 - Convert values stated in foreign currency to U.S. dollars using currency exchange rate on the last day of the tax year (even if asset was sold or transferred during the year)

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Penalty for failure to file
 - \$10,000 for initial failure to file
 - Additional \$10,000 penalty for each 30-day period (or part of period) for failure to file 90 days after receiving IRS notice of failure to file (max. \$50K)
- If IRS determines you have an interest in specified foreign financial assets and asks for information regarding the value of any asset, but you do not provide enough information to determine the value, presumption you own specified foreign financial assets and penalty applies if fail to file
- Reasonable cause exception available
 - The fact a foreign jurisdiction would impose civil or criminal penalty if you disclose does not constitute reasonable cause (per instructions to Form 8938)

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Penalty for underpayment of tax as a result of undisclosed specified foreign financial asset – 40% of underpayment (Code § 6662(j))
- Statute of limitations
 - Three year SOL from date Form 8938 filed
 - SOL remains open if failure to file Form 8938 or failure to report specified foreign financial asset
 - Whether the entire return or just part relating to Form 8938 remains open depends on whether the taxpayer can demonstrate reasonable cause (*see* Code § 6501(c)(8))
 - Six year SOL for failure to include > \$5,000 in income related to specified foreign financial assets (regardless of whether there was a requirement to file Form 8938)

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

■ Proposed Regulations § 1.6038D-6 – Specified Domestic Entity

- Intent to finalize during 2012
- Effective for tax years beginning after Dec. 31, 2011 (subject to final or temporary regs.)
- As currently proposed, domestic corporation, partnership or trust is deemed to be a specified domestic entity if it is formed or availed for the purpose of holding, directly or indirectly, SFFAs (determination made annually):
 - ❖ Entity has an interest in SFFAs that exceed the reporting threshold,
 - ❖ Entity is closely held by a specified individual, and
 - ❖ Either:
 - ❑ At least 50% of gross income is passive or 50% of assets produce or are held for the production of passive income, or
 - ❑ At least 10% of gross income is passive or 10% of assets produce or are held for production of passive income and entity is formed or available by specified individual with a principal purpose of avoiding 6038D reporting obligations
- Closely held – 80% owned (directly, indirectly or constructively) by one specified individual on last day of entity's tax year

Section 6038D: Specified Foreign Financial Asset Reporting (Form 8938)

- Proposed Regulations § 1.6038D-6
 - Excepted domestic entities
 - ❖ Publicly traded or member of affiliated group whose parent is publicly traded
 - ❖ Bank
 - ❖ REIT
 - ❖ RIC
 - ❖ Tax-exempts



Section 230 Disclaimer

- This document was not intended or written to be used, and cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.



Questions?



Backup Slides

- Current guidance re 6038D
 - T.D. 9567 (12/14/11) – temporary regulations for individual taxpayers effective for tax years beginning after Dec. 19, 2011
 - Proposed regulations for entities that, if enacted, will apply for tax years beginning after Dec. 31, 2011

FBAR – Report of Foreign Bank and Financial Accounts (TD F 90-22.1)

- Current, administrative deferral from reporting requirement

FBAR Deadline	Who Qualifies?	Which FBARs?	Guidance
6/30/2013	(3) Officer or employee of investment advisors registered with the SEC who have signature authority over, but no financial interest in, foreign financial accounts of persons that are not registered investment companies under the Investment Company Act of 1940	Calendar Year 2011 and prior years	FinCEN Notice 2012-1