

# Cooley

February 23, 2012

The U.S. Treasury Department and Internal Revenue Service recently released proposed regulations that provide guidance on the so-called Foreign Account Tax Compliance Act ("FATCA"). FATCA is the government's response to U.S. persons who have not reported income earned from their offshore financial assets and to the financial institutions that developed and promoted schemes to conceal such assets and income from the IRS. FATCA imposes significant administrative burdens on certain foreign investment funds, foreign banks and other foreign financial institutions (collectively, "FFIs"), on domestic investment funds that have non-financial foreign entities ("NFFEs") as limited partners, and on U.S. persons who make payments to FFIs and NFFEs.

The proposed regulations provide detailed guidance on the information reporting that will be required for accounts and financial interests owned by U.S. persons ("U.S. Accounts"), the due diligence that must be performed to identify U.S. Accounts, and other administrative requirements. Failure by an FFI to comply with these requirements will result in a 30% withholding tax being deducted from payments made by U.S. payors to the FFI. Payments subject to the withholding tax include payments of U.S.-source interest, dividends, rents, salaries, and gross proceeds from the sale of debt and equity instruments that produce U.S.-source interest or dividends. FFIs that comply with the information reporting and other requirements ("participating FFIs") generally will not have withholding tax deducted from the payments they receive, but will be required to deduct such tax from passthru payments they make to nonparticipating FFIs and recalcitrant account holders (i.e., account holders who fail to provide the participating FFI with the information required to determine whether an account is a U.S. Account). FFIs that are deemed-compliant, generally meaning FFIs that do not maintain U.S. Accounts or that are subject to an exemption because the IRS has determined that compliance with FATCA is not necessary to prevent U.S. tax evasion, will also be exempt from the withholding tax.

Domestic investment funds with NFFE partners and other U.S. persons making payments to NFFEs will be required to deduct the 30% withholding tax from payments made to an NFFE unless the NFFE establishes an exemption. Payments beneficially owned by NFFEs are exempt from the FATCA withholding tax if the NFFE is a publicly traded corporation, is an 'active' NFFE (meaning generally an NFFE if less than half of its gross income for the prior year is passive income or less than half of its assets held during the prior year are assets that produce or are held for the production of passive income), or is an NFFE that does not have substantial U.S. owners or that identifies all of its substantial U.S. owners to the applicable withholding agent and that withholding agent reports the required information with respect to such substantial U.S. owners to the IRS. Substantial U.S. owners are, generally, U.S. persons with at least a 10% interest (held directly or indirectly) in the NFFE. In general, the reporting burden imposed on NFFEs is much less onerous than the burden imposed on FFIs as NFFEs are expected to be able to certify their status on modified IRS W-8 Forms.

A draft FFI agreement is expected to be released later this year and FFIs that choose to enter into an FFI agreement may be able to do so sometime in the summer of 2013. The reporting requirements imposed on a participating FFI will gradually increase between 2014 and 2017. For 2014 and 2015, participating FFIs are only required to report the names, addresses, taxpayer identification numbers, account numbers, and account balances for U.S. Accounts. Reporting the income and gross proceeds of U.S. Accounts will be phased in beginning in 2016 and 2017, respectively. Importantly, while FFI agreements are intended to apply to all of the members of an FFI's affiliated group, until January 1, 2016 the proposed regulations have relaxed this requirement if a member of the affiliated group cannot comply with FATCA due to restrictions imposed by local law.

FATCA withholding generally will be required on payments made to FFIs after 2013 and will be required on certain passthru payments made after January 1, 2017. Additionally, grandfathered obligations (generally debt instruments outstanding on January 1, 2013) will be exempt from FATCA withholding.

Concurrent with the issuance of the proposed regulations, the U.S., France, Germany, Italy, Spain and the United Kingdom issued a joint statement indicating that the non-U.S. countries would work with the U.S. to create an alternative mechanism for FATCA compliance. The joint statement laid out a possible framework under which an FFI would report account information and remit any applicable U.S. taxes to the local tax authority, which would be passed on to the IRS. Where an agreement between the U.S. and another country is enacted, withholding on payments to FFIs in that country would generally be eliminated.

In response to comments from the financial community, the IRS took several significant steps aimed at addressing concerns over the administrative burdens FATCA would impose. Nonetheless, the proposed regulations present a significant, complex, and impending challenge for FFIs and NFFEs. If you have questions about FATCA please contact one of our tax attorneys or your regular Cooley contact.

### Circular 230 Disclosure

The following disclosure is provided in accordance with the Internal Revenue Service's Circular 230. Any tax advice contained in this alert is intended to be preliminary, for discussion purposes only, and not final. Any such advice is not intended to be used for marketing, promoting or recommending any transaction or for the use of any person in connection with the preparation of any tax return. Accordingly, this advice is not intended or written to be used, and it cannot be used, by any person for the purpose of avoiding tax penalties that may be imposed on such person.

This content is provided for general informational purposes only, and your access or use of the content does not create an attorney-client relationship between you or your organization and Cooley LLP, Cooley (UK) LLP, or any other affiliated practice or entity (collectively referred to as "Cooley"). By accessing this content, you agree that the information provided does not constitute legal or other professional advice. This content is not a substitute for obtaining legal advice from a qualified attorney licensed in your jurisdiction, and you should not act or refrain from acting based on this content. This content may be changed without notice. It is not guaranteed to be complete, correct or up to date, and it may not reflect the most current legal developments. Prior results do not guarantee a similar outcome. Do not send any confidential information to Cooley, as we do not have any duty to keep any information you provide to us confidential. This content may have been generated with the assistance of artificial intelligence (AI) in accordance with our [AI Principles](#), may be considered Attorney Advertising and is subject to our [legal notices](#).

---

## Key Contacts

Aaron Pomeroy Colorado	apomeroy@cooley.com +1 720 566 4108
---------------------------	----------------------------------------

---

This information is a general description of the law; it is not intended to provide specific legal advice nor is it intended to create an attorney-client relationship with Cooley LLP. Before taking any action on this information you should seek professional counsel.

Copyright © 2023 Cooley LLP, 3175 Hanover Street, Palo Alto, CA 94304; Cooley (UK) LLP, 22 Bishopsgate, London, UK EC2N 4BQ. Permission is granted to make and redistribute, without charge, copies of this entire document provided that such copies are complete and unaltered and identify Cooley LLP as the author. All other rights reserved.

