CLIFFORD CHANCE

Client Memorandum

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A Comprehensive Look at the Proposed FATCA Regulations

The U.S. Treasury Department ("**Treasury**") and the U.S. Internal Revenue Service (the "**IRS**") recently published proposed regulations implementing the Foreign Account Tax Compliance provisions of the Hiring Incentives to Restore Employment Act of 2010 (commonly referred to as "**FATCA**"), which provide guidance on how the IRS will apply new U.S. tax compliance rules beginning in 2014 to non-U.S. banks, financial intermediaries and investment vehicles.

The purpose of FATCA is to force non-U.S. banks, financial intermediaries, investment vehicles and certain insurance companies ("**Foreign Financial Institutions**" or "**FFIs**") to report information on accounts held by U.S. persons to the IRS.[1]

FATCA achieves that objective by generally imposing a 30% withholding tax on certain payments to FFIs ("**nonparticipating FFIs**" or "**Non-PFFIs**") that do not enter into a form agreement with the IRS (an "**FFI Agreement**") described in greater detail below and that are not otherwise exempt from the withholding tax. The withholding tax also is imposed on payments to certain persons that refuse to provide identifying information or waive the benefit of customer privacy laws that would prevent reporting to the IRS under an FFI Agreement ("**Recalcitrant Account Holders**").

The withholding tax generally is imposed on income and proceeds (including a return of original investment) from investments in U.S. financial assets ("**Withholdable Payments**"). It also is imposed on certain payments made by an FFI that has entered into an FFI Agreement (a "**participating FFI**" or a "**PFFI**") to the extent such payments are attributable to Withholdable Payments ("**Passthru Payments**").

Additionally, FATCA imposes a 30% withholding tax on Withholdable Payments and Passthru Payments made to certain non-U.S. entities that are not FFIs ("**Non-Financial Foreign Entities**" or "**NFFEs**") if the relevant entity does not provide information on its substantial U.S. owners (if any).

Among other things, the proposed regulations:

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[1] U.S. persons who invest in non-U.S. financial accounts are required to report those accounts to the IRS. The FATCA provisions reflect a concern that some U.S. persons with non-U.S. financial accounts are failing to comply with their reporting obligations.

- Extend the grandfathering provisions to obligations issued before January 1, 2013;
- Reserve on the treatment of "foreign" Passthru Payments and defer withholding on such payments until no earlier than January 1, 2017;
- Expand and define the categories of exempted entities;
- Contemplate that FFIs established in certain countries may be deemed compliant pursuant to an intergovernmental agreement;[2]
- Provide a transition period during which an FFI may become a PFFI or a "Registered Deemed Compliant FFI" (as defined below) notwithstanding the fact that certain of its branches or affiliates are prohibited by local law from complying with the due diligence, reporting or withholding obligations generally applicable to PFFIs;
- Provide simplified diligence procedures for smaller preexisting individual and entity accounts;
- Specify the documentation required for various types of entities to establish their exempt status;
- Require PFFIs to report certain foreign source payments that are made to Non-PFFIs in 2015 and 2016; and
- Provide guidance on the procedures necessary to verify FATCA compliance.

The proposed regulations are extensive, and this memorandum provides only a general overview.

In determining whether to enter into an FFI Agreement, an FFI must consider not only the scope of the obligations, but whether the FFI will be permitted to take such measures under its local law and whether affiliated FFIs are also able to comply. The options for FFIs, as we see them, are as follows:

1. FFI Agreement. An FFI can avoid the new 30% withholding tax by entering into an FFI Agreement to (a) comply with specified due diligence obligations to identify certain U.S. persons that hold accounts directly or indirectly with the FFI; (b) report certain information regarding those account holders; (c) comply with requests from the IRS for additional information regarding those account holders; (d) withhold tax on Withholdable Payments and Passthru Payments to Non-PFFIs and Recalcitrant Account Holders; (e) close accounts of Recalcitrant Account Holders; and (f) comply with certain verification obligations.
2. Agreement to Undertake Form 1099 Reporting. As an alternative to reporting certain account information under an FFI Agreement, an FFI may agree to undertake Form 1099 information reporting with respect to its account holders that are U.S. persons. The FFI generally would be required to maintain and report information regarding income and proceeds received from financial assets and their tax basis applying U.S. tax principles.
3. Satisfy the Requirements for Deemed Compliant Entities. An FFI can avoid the new 30% withholding tax if it qualifies as a "Deemed Compliant FFI" (as defined below). The proposed regulations define various categories of Deemed Compliant FFIs, including entities with certain procedures to limit their account holders, certain small or local FFIs, and certain institutions that provide account information to a withholding agent that assumes the relevant due diligence, reporting and withholding obligations.
4. Divest of Most U.S. Investments. An FFI that does not take any of the foregoing steps can avoid the new 30% withholding tax by divesting of U.S. investments, other than certain obligations that were outstanding on January 1, 2013, and interests in PFFIs that generate foreign Passthru Payments.

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[2] Simultaneously with the issuance of the proposed regulations, the United States, France, Germany, Italy, Spain and the United Kingdom issued a joint statement of intent to enter into such agreements.

5. Refund Under an Applicable Income Tax Treaty. If an FFI receives payments on which the new 30% withholding tax has been imposed and the FFI qualifies for the benefit of an income tax treaty, the FFI may apply for a refund to the extent that the withholding tax exceeds the tax allowed under the treaty. No interest will accrue on the over withheld tax.

The options for NFFEs, as we see them, are as follows:

1. Provide Information on Substantial U.S. Owners or Certify Lack of Substantial U.S. Owners. NFFEs may seek to limit or ensure that they do not have U.S. owners to minimize their diligence and reporting obligations.
2. Divest of Most U.S. Investments. Like FFIs, NFFEs (that are not otherwise exempted) can avoid the new 30% withholding tax by divesting of most U.S. investments, other than certain obligations that were outstanding on January 1, 2013, and interests in PFFIs that generate foreign Passthru Payments.

Foreign Entities Subject to FATCA

FFIs

An FFI is a non-U.S. person that:

1. Takes Deposits in a Banking or Similar Business: This includes commercial banks, building societies and other savings and banking institutions ("**Bank FFIs**").
2. Holds Financial Assets for the Account of Others as a Substantial Portion of the Institution's Business: This includes, for example, broker-dealers, clearing organizations, trust companies, custodial banks and entities acting as custodians with respect to the assets of employee benefit plans ("**Custodian FFIs**").
3. Engages Primarily in the Business of Investing or Trading in Financial Assets or Derivatives: This generally includes, but is not limited to, mutual funds, funds of funds, exchange-traded funds, hedge funds, private equity and venture capital funds, other managed funds, commodity pools and investment vehicles ("**Investing FFIs**"). An entity is treated as engaged primarily in the business of investing or trading in such assets if the entity's gross income from such activities equals or exceeds 50% of total gross income during the shorter of the three-year period ending at the close of the calendar year in which the determination is made and the period for which the entity has been in existence.
4. Is an Insurance Company that Issues Cash Value Insurance Contracts, Annuity Contracts, or Debt or Equity Instruments Linked to U.S. Assets: This generally includes insurance companies that issue contracts with an investment component to them ("**Insurance FFIs**"). It does not include insurance companies that solely issue insurance contracts with pure insurance protection (e.g. term life, disability, health and property and casualty insurance contracts).

Under the proposed regulations, certain entities are excluded from FFI treatment, are treated as being PFFIs, or are exempt from withholding because they pose a low risk of tax evasion. Such entities include: (i) "**Excepted FFIs**" (ii) "**Deemed Compliant FFIs**" and (iii) "**Exempt Beneficial Owners**".

Excepted FFIs

Excepted FFIs are excluded from the definition of FFI, and thus will not be subject to withholding. This category includes: (i) non-financial holding companies;[3] (ii) start-up companies; (iii) non-financial entities that are liquidating or emerging from

[3] This category does not include entities that function or hold themselves out to be an investment fund or investment vehicle whose purpose is to acquire or fund companies and hold the interests as capital assets for investment purposes.

reorganization or bankruptcy; (iv) hedging/financing centers of a non-financial group; and (v) foreign Section 501(c) entities, in each case meeting specific requirements.

Deemed Compliant FFIs

The term Deemed Compliant FFIs refers to certain FFIs that are deemed to be compliant without having concluded an FFI Agreement. There are three categories of Deemed Compliant FFIs: "**Registered Deemed Compliant FFIs**", "**Certified Deemed Compliant FFIs**" and "**Owner-Documented FFIs**".[4] These categories include entities with certain procedures to limit their account holders, certain small or local FFIs, and certain institutions that provide account information to a withholding agent that assumes the relevant due diligence, reporting and withholding obligations, as well as certain other types of entities that are unlikely to be used to facilitate the sheltering of overseas assets. Deemed Compliant FFIs are not subject to withholding, and (except for Owner-Documented FFIs) generally do not have to provide documentation or information on their account holders when receiving payments as an intermediary. However, certain Deemed Compliant FFIs that are intermediaries are still required to withhold and report on Withholdable Payments made to Non-PFFIs or Passive NFFEs (defined below) that do not provide information regarding their substantial U.S. owners.

Registered Deemed Compliant FFIs

A Registered Deemed Compliant FFI is required to register with the IRS and meet certain procedural requirements. An FFI is not eligible to be a Registered Deemed Compliant FFI unless all of the members of its "**Expanded Affiliate Group**"[5] are either PFFIs or Registered Deemed Compliant FFIs. Registered Deemed Compliant FFIs include: (i) local FFIs; [6] (ii) non-reporting members of PFFI groups;[7] (iii) qualified collective investment vehicles;[8] and (iv) restricted funds.[9]

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4 Although prior guidance from the IRS indicated that an entity would be treated as a Deemed Compliant FFI if it complied with procedures specified by the IRS to ensure that it does not maintain "U.S. Accounts" (as defined below), the proposed regulations do not give any further guidance on this and do not include it as a category of a Deemed Compliant FFI.

5 The term Expanded Affiliate Group means a group of entities with a threshold level of common ownership. Partnerships will not be treated as members of an Expanded Affiliated Group unless members of a group hold a majority interest in the partnerships.

6 In general, this category only applies if the FFI is a Bank FFI, a Custodian FFI or an Insurance FFI; is organized in a Financial Action Task Force ("**FATF**")-compliant jurisdiction; is subject to local regulation as a bank, securities broker or dealer, or investment advisor; has no fixed place of business in another jurisdiction; does not solicit account holders outside its jurisdiction; is required by its local tax laws to report or withhold on payments made to resident account holders; has no more than a de minimis number of non-resident account holders (or in the case of a local FFI organized in a European Union country, are non-residents of the European Union); implements policies and procedures to ensure that it does not open or maintain accounts for any non-resident "Specified U.S. Person" (as defined below), any Non-PFFI, or any entity controlled or beneficially owned by a Specified U.S. Person; conducts diligence on preexisting accounts of individual non-residents; and has no affiliates other than local FFIs organized in the same jurisdiction.

7 In general, this category only applies if the FFI is affiliated with a PFFI and complies with various requirements to ensure that it does not open or maintain accounts for Specified U.S. Persons, Passive NFFEs with substantial U.S. owners, or Non-PFFIs, and transfers any such accounts to a PFFI or U.S. institution.

8 In general, this category only applies to Investing FFIs that are regulated as an investment fund under local law whose investors or account holders are only PFFIs, Registered Deemed Compliant FFIs, U.S. persons that are not Specified U.S. Persons, or "Exempt Beneficial Owners" (as defined below).

9 In general, this category only applies if the FFI is an Investing FFI; is organized in an FATF-compliant jurisdiction; is regulated in such jurisdiction as an investment fund; distributes its interests only through PFFIs, Registered Deemed Compliant FFIs, "nonregistering local banks" (as defined below) and certain "restricted distributors" under agreements and fund documentation that prohibit sales to U.S. persons, Non-PFFIs, or Passive NFFEs with substantial U.S. owners, and that generally require the redemption of interests sold through a distributor

Certified Deemed Compliant FFIs

A Certified Deemed Compliant FFI is an FFI described below that has certified its status by providing a withholding agent with certain documentation. It does not have to register with the IRS. Certified Deemed Compliant FFIs include: (i) non-registering local banks;[10] (i) certain retirement funds; (iii) certain non-profit organizations; and (iv) FFIs with only low-value accounts.[11]

Owner-Documented FFIs

This category of Deemed Compliant FFI allows certain FFIs to have a withholding agent undertake its due diligence and reporting obligations on its behalf. The accounts have to be held by a designated withholding agent that agrees to undertake specific due diligence and reporting requirements in respect of the FFI's owners. This category is limited to Investing FFIs that do not have account holders that are Non-PFFIs, that do not issue debt to any person exceeding $50,000, and that satisfy certain other requirements.

Exempt Beneficial Owners

Exempt Beneficial Owners are not subject to withholding, provided that they furnish specified documentation to the relevant withholding agent. This category includes: (i) foreign governments;[12] (ii) international organizations; (iii) foreign central banks of issue; (iv) governments of U.S. possessions; (v) certain retirement funds; and (vi) entities wholly owned by one or more exempt beneficial owners. Accounts held solely by Exempt Beneficial Owners are not financial accounts for FATCA purposes, even if they are held through Non-PFFIs, and are therefore not subject to the diligence and reporting requirements with respect to accounts described below.

NFFEs

An NFFE is a non-U.S. entity that is not an FFI. Any NFFE that is not an "**Excepted NFFE**" (as discussed below) is a "**Passive NFFE**". Although a Passive NFFE is not required to enter into an FFI Agreement, it will be subject to withholding unless it provides either a written certification that it does not have any substantial U.S. owners or the name, address and tax identification number ("**TIN**") of each substantial U.S. owner of the NFFE. Generally, a substantial U.S. owner is a U.S. person that holds more than a 10% direct or indirect interest in the Passive NFFE. The proposed regulations provide rules for identifying a U.S. person's indirect ownership in a Passive NFFE.

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that ceases to qualify; conducts diligence on preexisting accounts that are held directly by ultimate investors; and implements policies and procedures to ensure that it does not open or maintain direct accounts for any Specified U.S. Person, any Non-PFFI, or any entity controlled or beneficially owned by a Specified U.S. Person.

10 In general, this category applies to an FFI that is licensed solely as a bank and is primarily engaged in making loans and taking deposits; that has no fixed place of business and does not solicit account holders outside its country of organization; that has a limited amount of assets on its balance sheet and on any combined balance sheet with affiliates; that is required under local law to either perform information reporting or withholding with respect to resident account holders; and that has no FFI affiliates that are not themselves nonregistering local banks.

11 This category applies to Bank FFIs and Custodian FFIs that, together with any affiliates, do not maintain any accounts that exceed $50,000 and that have no more than $50 million in assets.

12 The principles related to the limited exemption from U.S. taxation of certain income of qualifying foreign sovereigns generally apply to determine if a beneficial owner qualifies as a foreign government.

Excepted NFFEs

Excepted NFFEs are not subject to withholding or due diligence requirements. The categories of Excepted NFFEs include the following: (i) publicly traded corporations the stock of which is regularly traded on one or more established securities markets for a calendar year; (ii) affiliated entities related to a publicly traded corporation; (iii) territory entities that are, directly or indirectly, wholly owned by one or more bona fide residents of the same U.S. possession under the laws of which the entity is organized; (iv) Exempt Beneficial Owners; (v) active NFFEs that have income and assets that meet certain requirements;[13] and (vi) Excepted FFIs.

Payments Covered By the New Withholding Tax

In General

The definition of Withholdable Payment generally includes (i) any U.S. source payment of interest, dividends, rents and other fixed or determinable annual or periodical gains, profits, and income ("**FDAP Income**"), and (ii) gross proceeds from the sale, exchange or disposition (including the retirement or redemption) of property of a type that can produce U.S. source dividend or interest payments (generally, stock and debt obligations of U.S. persons). Payments that are effectively connected with the conduct by the recipient of a trade or business in the United States, payments of principal and interest from certain short-term obligations, and certain other payments are excluded from the definition of Withholdable Payments.[14]

Certain payments will be considered exempt from the withholding tax, including payments made to a withholding agent who has no control over or custody of the money or property owned by a payee or beneficial owner of a payment, or lacks the knowledge of the facts giving rise to the payment,[15] payments made prior to January 1, 2015 with respect to a preexisting obligation where the withholding agent does not have documentation as to the payee's Non-PFFI status,[16] payments made under a grandfathered obligation, and payments made on debt or equity that is regularly traded on an established securities market.

PFFIs also will be required to withhold on Passthru Payments as discussed in further detail below.

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[13] An active NFFE will meet these requirements if less than 50% of its gross income for the preceding calendar year is passive income such as dividends, interest, rent and royalties not derived from the active conduct of a trade or business conducted by employees of the NFFE, annuities, and so forth, and less than 50% of the assets held by the NFFE at any time during the preceding calendar year are assets that produce or are held for the production of passive income.

[14] Other excluded payments include certain payments in the ordinary course of the withholding agent's business for non-financial services, goods and the use of property, and gross proceeds from the sale of property that can produce income that is excluded from the definition of a Withholdable Payment.

[15] An example of this circumstance arising would be in the case of a bank transfer of money originally received by an individual as a dividend between two of the individual's bank accounts, where the transferring and receiving banks do not have knowledge of the facts giving rise to the payment.

[16] This exception applies unless the payee is considered a prima facie FFI. Examples of factors that indicate a payee is a prima facie FFI include the withholding agent having electronically searchable information showing designation of the payee as a non-qualified intermediary or qualified intermediary under the current U.S. withholding rules, the account is managed in the United States and North American Industry Classification System codes indicate the payee is a financial institution, or the Standard Industrial Classification Codes indicate the payee is a financial institution.

Grandfathered Obligations

The proposed regulations provide an expanded scope of grandfathered obligations that are not subject to the 30% withholding tax. Under the proposed regulations, payments made on and the gross proceeds from the sale, exchange or disposition of any obligation outstanding on January 1, 2013 are excluded from the definition of Withholdable Payment and Passthru Payment.[17] The term "obligation" includes any legal agreement that produces or could produce a Withholdable Payment or Passthru Payment, except for (i) instruments that are treated as equity for U.S. tax purposes; (ii) legal agreements that lack a definitive expiration or term (e.g., deposit type agreements); (iii) brokerage, custodial and similar agreements to hold financial assets for the account of others and to make and receive payments of income and other amounts with respect to such assets, and (iv) master agreements intended to apply to a series of transactions between parties that merely set forth general terms and conditions and lack the specific terms necessary to conclude a particular contract. Examples of obligations for these purposes include (i) debt instruments; (ii) binding agreements to extend credit for a fixed term if the material terms are fixed on the agreement date (e.g. advances made under a revolving credit facility); (iii) life insurance contracts payable upon the earlier of a set age or death; (iv) term certain annuity contracts, and (v) derivatives transactions entered into under an ISDA Master Agreement and evidenced by a confirmation.

Any material modification of an obligation will result in the obligation being treated as newly issued as of the effective date of the modification. Existing U.S. tax regulations will apply for purposes of determining whether there is a material modification of a debt obligation; in the case of other obligations, the determination will be based on all the relevant facts and circumstances. For example, if a U.S. borrower and its lenders agree to materially restructure a debt obligation that was outstanding on January 1, 2013 and the restructuring occurs after that date, the restructured obligation can generate Withholdable Payments and Passthru Payments. This may impede negotiated debt restructurings after January 1, 2013.

The proposed regulations request comments regarding the application of the grandfathering rules to equity interests in an entity that holds assets that give rise to grandfathered payments, such as the most junior tranche of interests in a securitization vehicle that holds primarily grandfathered obligations and that will liquidate within a specified time frame due to the nature of the investments it holds and limitations on its reinvestment of funds in other assets.

FFI Agreements

Under an FFI Agreement, a PFFI generally must: (i) comply with specified due diligence and documentation requirements to identify accounts ("**U.S. Accounts**") that are held by certain U.S. persons ("**Specified U.S. Persons**")[18] or by non-U.S. entities with one or more owners that are Specified U.S. Persons and whose ownership exceeds certain thresholds ("**U.S. Owned Foreign Entities**"); (ii) report certain information with respect to U.S. Accounts maintained by the PFFI; (iii) comply with requests from the IRS for additional information with respect to any U.S. Account maintained by the PFFI; (iv) withhold tax on Withholdable Payments and Passthru Payments made to account holders that are Non-PFFIs or Recalcitrant Account Holders;[19]

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[17] An obligation that is treated as indebtedness is considered outstanding if it has an issue date before January 1, 2013. Any other obligation is considered outstanding if there is a legally binding agreement establishing the obligation was executed between the parties before January 1, 2013.

[18] Specified U.S. Persons do not include certain publicly traded corporations and their subsidiaries, tax exempt organizations, charitable trusts, retirement plans, federal, state and local governments, banks, real estate investment trusts, regulated investment companies and common trust funds.

[19] Prior guidance stated that the IRS is considering measures for dealing with long-term Recalcitrant Account Holders, including terminating FFI

(v) seek appropriate waivers of any applicable customer privacy law that prevents reporting to the IRS in respect of U.S. Accounts under the FFI Agreement, and if such waivers are not obtained within a reasonable period, to close the relevant U.S. Account; and (vi) comply with certain verification obligations.

A draft FFI Agreement is expected to be released by the summer of 2012. FFIs are advised to enter into an FFI Agreement by June 30, 2013 to ensure that they are treated as PFFIs by 2014, when withholding will begin on Withholdable Payments.

An FFI generally cannot obtain the status of a PFFI or a Registered Deemed Compliant FFI unless each other FFI that is part of the same Expanded Affiliated Group also has the status of a PFFI or a Registered Deemed Compliant FFI, and each such FFI applies the relevant requirements at each of its branches, offices and divisions.[20] The proposed regulations contain a limited exception for branches and affiliates that are prohibited under local law from reporting information on U.S. Accounts to the IRS, withholding on payments made to Recalcitrant Account Holders and Non-PFFIs, or closing the accounts of Recalcitrant Account Holders and Non-PFFIs. Through the end of 2015, such branches or affiliates will not disqualify the remainder of the Expanded Affiliated Group provided that the branches or affiliates (i) agree to undertake certain due diligence obligations, to retain account holder documentation for six years, and to report with respect to U.S. Accounts to the extent permitted under local law; (ii) agree not to open U.S. Accounts or accounts for Non-PFFIs; and (iii) are subject to withholding as Non-PFFIs. This exception effectively provides a limited period during which an Expanded Affiliated Group can either rearrange the business operations of branches and affiliates that are unable to comply with the FFI Agreement, or for the governments of jurisdictions in which such branches or affiliates are located to modify their laws to allow for compliance with FATCA.

Identification of U.S. Accounts

The proposed regulations provide extensive due diligence procedures that PFFIs must apply to identify U.S. Accounts.[21] Except where an exclusion or simplified diligence rules apply, a PFFI has to obtain specific types of documentation depending on the nature of the account holder and the nature of the account.[22] Generally, a PFFI will have to obtain documentation on U.S. tax Forms W-9 or W-8 and additional documentation in certain cases. In some circumstances, a PFFI will have to review supporting documentation to verify that it supports the status claimed by the account holder. In the absence of documentation, PFFIs may rely on presumption rules.[23]

Agreements when an FFI has numerous long-term Recalcitrant Account Holders remaining after a reasonable amount of time. However, the proposed regulations do not provide any additional information on what the IRS is considering in regards to long-term Recalcitrant Account Holders.

[20] Each member of an FFI Expanded Affiliated Group will be required to designate a "**Lead FFI**" to initiate and manage its online registration process. The Lead FFI must enter the system to register itself as a "**Member FFI**" and identify the other Member FFIs of the Expanded Affiliated Group that will register for participating, limited, or Registered Deemed Compliant FFI status. Each Member FFI will be assigned a unique FATCA identifier ("**FATCA ID**") to be used in completing the registration process and associating Member FFIs with the Expanded Affiliated Group.

[21] Withholding agents will have similar, though less extensive, due diligence obligations.

[22] The proposed regulations contain a number of simplifying rules for preexisting accounts and different types of transition rules for different types of payees.

[23] For example, if a PFFI cannot determine a payee's status as an individual or an entity, it may presume that the payee is an individual if it appears to be an individual, otherwise it must presume that it is an entity. If a PFFI is unable to determine U.S. or non-U.S. status, then an entity is presumed to be non-U.S. if its EIN begins with "98", has a non-U.S. address or telephone number, or has a name that indicates that it is a per se non-U.S. corporation.

The due diligence procedures require PFFIs to review account information for certain U.S. indicia. These procedures are different depending on whether the accounts are held by individuals or by entities, and whether the accounts are preexisting or established after the effective date of the PFFI's FFI Agreement.

Accounts Held by Individuals

Preexisting individual accounts

Certain accounts are exempt from review, including (i) depository accounts of $50,000 or less; (ii) accounts with a balance of $50,000 or less that are not cash value insurance or annuity contracts and not previously identified as held by a Specified U.S. Person; and (iii) cash value insurance or annuity contracts held by individuals with a value of $250,000 or less.

Preexisting offshore accounts with a balance of more than $50,000 ($250,000 in the case of a cash value insurance or annuity contract), but less than $1 million are subject only to a review of electronically searchable data for U.S. indicia.[24] Preexisting accounts with a balance of $1 million or more are subject to a review of electronically searchable data and non-electronic files[25] for U.S. indicia, including an inquiry of the actual knowledge of any relationship manager associated with the account.

If a PFFI has obtained a Form W-8 and documentary evidence of foreign status, or a PFFI previously obtained documentation establishing foreign status to meet its obligations under current U.S. withholding rules (e.g., as a qualified intermediary, withholding foreign partnership or withholding foreign trust) or to fulfil its reporting obligations as a U.S. payor, then the only diligence required is an inquiry regarding the actual knowledge of any relationship manager that an account holder is a U.S. person.

If U.S. indicia are found in the review of any of the accounts described above, additional documentation is required.[26]

Newly-established individual accounts

PFFIs are generally required to collect IRS Forms W-8 or W-9 (or certificates of tax residence or government issued identification in place of a Form W-8) and will be required to review the information provided at the opening of the account, including identification documents and any documentation collected under anti-money laundering or know-your-customer rules. If U.S. indicia are identified as part of that review, the relevant PFFI must obtain additional documentation or treat the account as held by a Recalcitrant Account Holder.

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[24] U.S. indicia include (i) identification of an account holder as a U.S. person; (ii) a U.S. place of birth; (iii) a U.S. address; (iv) a U.S. telephone number; (v) standing instructions to transfer funds to an account maintained in the United States; (vi) a power of attorney or other signatory authority granted to a person with a U.S. address; or (vii) a U.S. "in-care-of" or "hold mail" address that is the sole address the FFI has indentified for the account holder.

[25] Review of non-electronic files is limited to the current customer files and certain other documents, and is required only to the extent that the electronically searchable files do not contain sufficient information about the account holder such as lacking an account holder's nationality and/or residence status, address, or telephone number.

[26] The type of documentation required depends on the type of indicia found. Generally, PFFIs will be required to collect Form W-8 or Form W-9 and additional documentary evidence of foreign status in particular circumstances.

Accounts Held by Entities

Preexisting entity accounts

Accounts with a balance of $250,000 or less and not previously identified as held by a Specified U.S. Person are exempt from review. Accounts of passive investment entities with balances of less than $1 million are subject to review of anti-money laundering and know-your-customer records and other existing account information. For accounts of passive investment entities with balances of more than $1 million, a PFFI must either obtain information for all substantial U.S. owners or a certification that the entity has no substantial U.S. owners.

New entity accounts

Accounts of another FFI (other than an Owner-Documented FFI for which the PFFI has agreed to perform reporting) are exempt from documentation identifying substantial U.S. owners. Accounts of an entity engaged in an active non-financial trade or business or otherwise excepted from documentation requirements are exempt from documentation of substantial U.S. owners. PFFIs will be required to determine whether any other entity (essentially passive investment entities) has any substantial U.S. owners upon opening a new account, generally by obtaining a certification from the account holder.

Reporting of U.S. Accounts

A PFFI generally must report the following information pursuant to an FFI Agreement with respect to each U.S. Account:

- The name, address and TIN of each account holder that is a Specified U.S. Person;
- In the case of any account holder that is a 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 (generally, at year-end); and
- The gross receipts and gross withdrawals or payments from the account. For this purpose, gross receipts must be segregated into the gross amount of dividends, the gross amount of interest, other income and gross proceeds from the sale or redemption of property.

A PFFI may determine the amount and character of the payments based on the same principles that the PFFI uses to report information on its resident account holders to the local tax authorities or any reasonable method of reporting consistent with accounting principles generally used by the PFFI for payments that are not reported to local tax authorities. It does not need to be determined using U.S. federal income tax principles.

Alternatively, a PFFI may elect to comply with the IRS Form 1099 information reporting provisions that would apply if such PFFI were a U.S. person and each holder of a U.S. Account that is a Specified U.S. Person or U.S.-Owned Foreign Entity were an individual and citizen of the United States.[27]

The proposed regulations provide transitional reporting rules for calendar years 2013, 2014 and 2015. PFFIs do not have to report gross receipts or gross withdrawals or payments from the accounts for calendar years 2013 or 2014. For calendar year

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[27] A PFFI that makes this election must still report the name, address, and TIN of each account holder that is a Specified U.S. Person and, in the case of any account holder that is a U.S.-Owned Foreign Entity, the name, address, and TIN of each substantial U.S. owner of such entity, as well as the relevant account numbers; however, an FFI that makes this election will not have to report the account balance or value or the gross receipts and gross withdrawals of payments.

2015, PFFIs do not have to report gross receipts or gross withdrawals from the accounts, but must report payments made from the accounts other than payments from the gross proceeds from the sale or redemption of property.

Withholding on Passthru Payments to Recalcitrant Account Holders and Non-PFFIs

The proposed regulations contemplate the beginning of withholding on foreign Passthru Payments no earlier than 2017, but do not define or elaborate on the rules applicable to such payments.[28] For 2015 and 2016, PFFIs must report the aggregate amount of non-U.S. source FDAP Income paid to each Non-PFFI.[29]

Prior guidance described a Passthru Payment regime that may serve as a model for withholding on payments made by Investing FFIs, but presents significant difficulties for payments made by Bank FFIs, Custodian FFIs and Insurance FFIs.[30] Under such guidance, a Passthru Payment is any "payment" to the extent of (i) the amount of the payment that is a Withholdable Payment; plus (ii) the amount of the payment that is not a Withholdable Payment multiplied by (A) in the case of a "Custodial Payment" (as defined below), the "Passthru Payment Percentage" (determined on quarterly testing dates and calculated as described below) of the entity that issued the interest or instrument, or (B) in the case of any other payment, the Passthru Payment Percentage of the PFFI making the payment. The effect of this definition is to:

- Impose withholding on payments that a PFFI receives from another FFI as custodian for a Non-PFFI or Recalcitrant Account Holder based on the Passthru Payment Percentage of the lower-tier FFI; and
- Impose withholding on payments that a PFFI makes to a Non-PFFI or Recalcitrant Account Holder in its own capacity (e.g., as a borrower or issuer of stock) based on the PFFI's own Passthru Payment Percentage.

The prior guidance contemplated that the FFI's Passthru Payment Percentage would be determined by dividing the sum of the FFI's U.S. assets held on each of the last four quarterly testing dates, by the sum of the FFI's total assets held on those dates. If a PFFI or Deemed Compliant FFI does not calculate and publish its Passthru Payment Percentage, that percentage would be deemed to be 100%. A U.S. asset will include any asset to the extent that it is a type that could give rise to a Passthru Payment.

Establishing Compliance

PFFIs are required to adopt written policies and procedures for identifying and documenting account holders and for complying with their withholding and reporting requirements. PFFIs are required to conduct periodic reviews to ensure their compliance with their policies and procedures, and responsible officers will have to periodically certify to the IRS that they are in compliance. In addition, a responsible officer of the PFFI must certify to the IRS that the enhanced review of high-value accounts has been completed within one year of the effective date of the FFI Agreement, and to the best of the responsible officer's knowledge, after conducting a reasonable inquiry, the PFFI did not have any formal or informal practices or procedures in place at any time

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28 The preamble to the proposed regulations indicates that the Treasury anticipates that future guidance will prevent U.S. financial institutions that act as agents and intermediaries from serving as "blockers" for Passthru Payment reporting and withholding.

29 The proposed regulations also contemplate that certain undefined "other financial payments" will be subject to reporting.

30 The proposed regulations exclude debt and equity interests in Bank FFIs, Custodian FFIs and Insurance FFIs from the definition of "financial accounts", unless the value of such debt or equity interests is determined primarily by reference to assets that give rise to Withholdable Payments. The exclusion of such debt and equity interests suggests that payments on such interests will not be subject to Passthru Payment withholding, because the regulations provide no mechanism for determining the identity of a holder of such debt or equity interests. However, the reporting regime for 2015 and 2016 does not clearly exclude payments made on such debt and equity interests to Non-PFFIs.

from August 6, 2011 through the date of such certification to assist account holders in the avoidance of the FATCA regime. A responsible officer of the PFFI also must certify to the IRS that the PFFI has completed the account identification procedures and documentation requirements for all preexisting financial accounts or treats them as required by the FFI Agreement within two years of the effective date of the FFI Agreement.

The IRS may also request additional information of PFFIs including account statements. If the IRS identifies concerns about the compliance of the FFI based on the reporting and certifications provided by the FFI, the IRS may require an audit by an external auditor approved by the IRS. However, PFFIs will not be required to have periodic external audits and will not be subject to random audits by the IRS. It is likely that the FFI Agreement will specify the standards for external audits and the requirements for self-reporting of violations.

Obligations of Withholding Agents

Generally, a withholding agent is any party that has the control, receipt, custody, disposal or payment of any Withholdable Payment, including non-U.S. entities. A withholding agent generally must withhold tax at a 30% rate on Withholdable Payments made to an FFI that is not a PFFI or a Deemed Compliant FFI, or to a NFFE that is not an Excepted NFFE and that does not provide information regarding its substantial U.S. owners. Withholding agents will be liable for any amounts required to be withheld and deposited that they fail to withhold or deposit.

In applying these obligations, a withholding agent must determine whether to treat entities to which it makes Withholdable Payments as U.S. persons, PFFIs, Non-PFFIs, Excepted FFIs, Deemed Compliant FFIs, Exempt Beneficial Owners, Excepted NFFEs, or Passive NFFEs. As noted above, withholding agents will be required to follow similar, though less extensive, due diligence procedures to those described above.

Credits and Refunds

The 30% withholding tax imposed by FATCA will be collected notwithstanding any reduction or exemption from tax that may apply under any domestic exemption or any applicable tax treaty. Beneficial owners of payments on which FATCA withholding is imposed generally are entitled to a refund or credit of the tax against their income tax liability. However, a Non-PFFI that is the beneficial owner of a Withholdable Payment is not entitled to a refund or credit unless it is entitled to a reduced rate of tax with regard to the Withholdable Payment under an applicable income tax treaty, and no interest will accrue on the refund.[31] In addition, an NFFE that seeks a refund or credit of the withholding tax must provide documentation regarding its substantial U.S. owners, except to the extent that the NFFE is entitled to a reduced rate of tax under an applicable income tax treaty.

A Withholdable Payment attributable to a return of invested capital may not be treated as income covered by an income tax treaty. The proposed regulations do not clarify how treaty relief might apply to a Withholdable Payment that is a return of capital.

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[31] If a PFFI elects to have a withholding agent withhold on Withholdable Payments or Passthru Payments made to it, rather than act as a withholding agent for Passthru Payments it makes to its account holders, the PFFI must agree to waive any right under any treaty of the United States with respect to any amount deducted and withheld pursuant to the election.

Intergovernmental Framework

Simultaneously with the issuance of the proposed regulations, Treasury issued a joint statement with France, Germany, Italy, Spain and the United Kingdom ("**Partner Countries**") regarding an intergovernmental approach for the implementation of FATCA. In general, the United States and each Partner Country stated its intention to enter into reciprocal agreements for collecting and exchanging information on accounts held by U.S. persons in the Partner Countries, and on accounts of residents of the Partner Countries in the United States.

Under the agreements, it is anticipated that each Partner Country will (i) implement legislation to require FFIs to collect and report required information to the tax authorities of the Partner Country; (ii) enable FFIs in the Partner Country to apply the necessary diligence to identify U.S. Accounts; and (iii) automatically transfer the information reported by the FFIs to the United States. It is anticipated that the United States will (i) eliminate the obligation of Partner Country FFIs to enter into a separate FFI Agreement directly with the IRS; (ii) allow the FFI to report information to the Partner Country instead of directly to the IRS (if registered with the IRS or exempt from registering); (iii) eliminate U.S. withholding under FATCA on payments to FFIs established in the Partner Country; (iv) not require the FFI to terminate the account of a Recalcitrant Account Holder; and (v) not require the FFI to impose Passthru Payment withholding on payments to Recalcitrant Account Holders or to other FFIs organized in the Partner Country or one of the other Partner Countries. FFIs in Partner Countries that meet the requirements of the applicable intergovernmental agreement and implementing legislation will be treated as Registered Deemed Compliant FFIs if all FFI members of the FFI's Expanded Affiliated Group are either PFFIs or Registered Deemed Compliant FFIs.

Although the Treasury's joint statement refers to reciprocity in information exchanges, it is unclear what enhanced due diligence or reporting requirements will be imposed on U.S. financial institutions in respect of their non-U.S. account holders.

The foregoing is not intended or written to be used, and cannot be used by any person, for the purposes of avoiding U.S. federal income tax penalties or to promote or market the matters addressed herein.

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