Global IRW Newsflash

The new proposed FATCA regulations: Overview

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Information reporting and withholding (IRW)

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On October 27, 2009, members of the U.S. Senate Finance Committee and the U.S. Ways and Means Committee unveiled the Foreign Account Tax Compliance Act of 2009 ("FATCA"), which was a comprehensive proposal to clamp down on U.S. tax evasion and improve taxpayer compliance by providing the Internal Revenue Service ("IRS") with new administrative tools to detect and deter offshore tax abuses. The provisions of FATCA were ultimately enacted on March 18, 2010, as part of the Hiring Incentives to Restore Employment Act of 2010, Pub. L. 111-147 (H.R. 2847) (the "Act"). Section 501(a) of the Act added chapter 4 (sections 1471 - 1474) to Subtitle A of the Internal Revenue Code. Chapter 4 expands the U.S. information reporting regime by imposing documentation, withholding, and reporting requirements on payments to and received by Foreign Financial Institutions ("FFIs") and Non-Financial Foreign Entities ("NFFEs").

FATCA's statutory provisions were intentionally broad and gave considerable discretion to the U.S. Department of the Treasury ("Treasury") and the IRS to narrow its scope in the implementing regulations. Notice 2010-60, released in August 2010, provided the first directional thinking on how the provisions of FATCA would operate. Treasury and the IRS subsequently issued two additional Notices (collectively these three Notices are referred to as the "Notices") that provided additional guidance on how FATCA's provisions would operate.

On February 8, 2012, Treasury and the IRS issued proposed regulations that provide details on many of the principles introduced in the Notices. The proposed regulations also incorporate some of the ideas and suggestions received from various stakeholders. The regulations also include several provisions that were not included in the Notices.

PwC Observation: Although these regulations are only proposed and do not have the authority of final regulations, they provide enough detailed guidance for financial institutions and NFFEs to understand and assess their current FATCA readiness. These assessments should focus on what information gaps exist, what system changes and process enhancements will need to be made, and how to communicate with internal and external stakeholders, such as customers and third-party service providers.

The following is an overview of the proposed regulations. Given the number of significant concepts and provisions in the proposed regulations and the related preamble, PwC will issue subsequent insights that will provide additional information on certain areas covered by the proposed regulations. PwC's thought leadership materials related to FATCA can be found at http://www.pwc.com/us/fatca.

In addition to distributing written materials explaining FATCA's provisions and how they will operate, PwC also will host a series of webcasts on FATCA-related topics. These webcasts will be hosted by a panel of PwC specialists who have been assisting financial institutions and other clients around the globe with FATCA implementation projects. The first webcast, which addressed the highlights of the proposed regulations, took place on February 21, 2012 (if you missed the webcast it can be replayed by visiting http://event.on24.com/r.htm?e=397562&s=1&k=BCEC1CF013FF5FF713472CF518427E0F). Our next webcast will take place on March 7, 2012, and will focus on some of the technology-related issues that will arise as financial institutions implement FATCA. To register for the next webcast, please visit http://www.meetpwc.com/event/m2c53c-120RCSJ795RUO.

Executive Summary

FATCA's rules are set forth in chapter 4 of the Internal Revenue Code ("Code") and generally apply after December 31, 2012, although the withholding obligations have been delayed in the proposed regulations. Generally, these provisions require withholding agents (including U.S. Financial Institutions ("USFIs")) to withhold 30-percent tax on any "withholdable payment" made to an FFI or NFFE if the FFI or NFFE fails to comply with FATCA's new reporting, disclosure, and other related requirements. Withholdable payments include certain U.S.-source fixed or determinable annual or periodic ("FDAP") income (such as dividends and interest paid by U.S. persons) and gross proceeds from the sale of a security that could generate U.S.-source dividends or interest. Additionally, FFIs generally are required to withhold 30-percent tax on "passthru payments" paid to recalcitrant account holders or to other FFIs that do not enter into an agreement with the IRS, or qualify as exempt or "deemed compliant" (referred to as non-participating FFIs).

FATCA's primary goal is to provide the IRS with an increased ability to detect U.S. tax evaders concealing their assets in foreign accounts and investments by encouraging FFIs and NFFEs to comply with a new set of tax information reporting and withholding rules or suffer the consequences of non-compliance, primarily being subject to withholding tax on the receipt of withholdable payments or passthru payments. FATCA's provisions are in addition to, and do not replace, the existing non-resident alien ("NRA") withholding rules in chapter 3 of the Code ("NRA withholding"). The statute directs Treasury and the IRS to promulgate regulations that coordinate the two withholding regimes while avoiding imposing double withholding tax and preserving most of the extensive procedural rules currently in place under chapter 3 withholding.

PwC Observation: The government recognizes that FATCA will be most effective if no one suffers the chapter 4 withholding tax -- that is, if most FFIs and NFFEs opt to comply with the documentation, due diligence, and reporting procedures. The proposed regulations, therefore, attempt to ease potentially excessive burdens of compliance. However, even with the lessening of the burdens, they can be substantial.

On February 8, 2012, Treasury and the IRS published the highly anticipated proposed FATCA regulations. Simultaneous with the issuance of the proposed regulations, the governments of the United States, France, Germany, Italy, Spain, and the United Kingdom released a joint statement explaining that they are exploring a common approach to FATCA implementation through domestic reporting and automatic information exchange systems (the "Joint Statement"). The Joint Statement also emphasizes the willingness of the United States to reciprocate by automatically collecting and exchanging information on accounts held in U.S. financial instututions by residents of each of the respective countries.

PwC Observation: The goal of these potential bilateral agreements is to overcome legal restraints on FFIs providing account holder information directly to the IRS where local privacy laws restrict FFIs from doing so. It is anticipated that the government will be negotiating these agreements with many of its trading partners so that local FFIs can comply with FATCA by reporting directly to their local tax authority. It is also anticipated that FFIs in these jurisdictions will not be required to impose withholding on passthru payments.

Treasury and the IRS have scheduled a public hearing on the proposed regulations on May 15, 2012. The IRS has requested that comments be submitted by April 30, 2012.

Among the more notable changes in the proposed regulations from the Notices are the following:

- Expanded Definition of FFI and Additional Categories of Deemed-Compliant FFIs. The proposed regulations expand the definition of FFI to include insurance companies. In addition, the proposed regulations expand the categories of deemed-compliant financial institutions to reduce or eliminate the compliance burdens for entities that are deemed to pose a low risk of tax evasion.

- Guidance on Procedures Required to Verify Compliance. The proposed regulations modify the Notices by providing that a responsible officer of an FFI will be required to certify that the FFI has complied with the terms of the FFI agreement. In addition, verification of compliance through a third-party auditor is not required.

- Transition Rule for Affiliates with Legal Prohibitions on Compliance. The proposed regulations provide a two-year transition rule (to January 1, 2016) for certain members of an expanded affiliated group to become a participating or deemed-compliant FFI. The transition period provides FFIs located in jurisdictions that have laws that prohibit the tax withholding or reporting required under FATCA with additional time to fully implement FATCA, without preventing other FFIs within the same expanded affiliated group from entering into an FFI agreement. However, these FFIs must agree to perform due diligence to identify U.S., nonparticipating FFIs and recalcitrant accounts and maintain certain records during this transition period, and will be subject to FATCA withholding until the local law situation is resolved.

- Definition of "Financial Account." The proposed regulations refine the definition of financial account to exclude most debt and equity securities issued by banks and brokerage firms, while focusing on traditional bank, brokerage and money market accounts, and equity interests in investment vehicles including hedge and private equity funds. Moreover, the definition focuses on which types of insurance contracts are subject to FATCA.

- Modification of Due Diligence Procedures for Identifying and Classifying Financial Accounts. The proposed regulations reduce the burden associated with reviewing records of pre-existing accounts to determine U.S. status by increasing the monetary threshold for reviews and eliminating the special rules in the Notices for so-called "private banking accounts."

- Passthru Payments. The proposed regulations extend the date on which FATCA withholding begins on foreign passthru payments from January 1, 2015, until January 1, 2017. However, during this interim period, an FFI must report the aggregate amount of certain payments to each non-participating FFI as a means to reduce the incentive for non-participating FFIs to use participating FFIs to block the application of the FATCA rules.

- Exemptions from FATCA Withholding. The proposed regulations exclude from withholding payments of interest on certain short-term obligations and payments made in the ordinary course of a withholding agent's business for nonfinancial services, goods and the use of property (such as wages and rent).

- Reporting Requirements. The proposed regulations extend the period for which limited reporting with respect to U.S. accounts can be provided to the IRS. This change was another acknowledgment of the additional time needed by financial institutions to make the system and process upgrades necessary for FATCA compliance.

- Grandfathered Obligations. The proposed regulations increase the number of obligations that qualify for grandfathered status by including obligations outstanding as of January 1, 2013 (the Notices included obligations outstanding on March 18, 2012), and identify certain obligations (such as debt instruments, revolver credit facilities, lines of credit, certain life insurance contracts, term-certain annuity contracts, and derivatives under an ISDA master agreement) as being eligible for grandfathered status.

- New Terms. The proposed regulations provide a list of defined terms, many of which are used under the current NRA withholding and domestic information reporting rules (chapters 3 and 61). While in most cases the terms and definitions in the proposed regulations are consistent with current rules, the proposed regulations provide that Treasury and the IRS intend to review the definitions under the current rules to conform them to the definitions in the proposed FATCA regulations, effective January 1, 2014.

  PwC Observation*: The regulations provide detailed guidance consistent with the information in the Notices and recent comments from senior Treasury officials, and show an attempt by Treasury and the IRS to balance the burdens of compliance with the goals of FATCA. The regulations are, unfortunately, extremely intricate, with many cross-references to other sections of the Code and regulations and contain a number of procedures that are consistent with those found in existing NRA withholding rules. Although there are a number of newly defined terms in the proposed regulations, the regulations also reflect an*

overall attempt to rely on self-ceritification by payees and FFIs. Finally, many of the deadlines in the proposed regulations remain consistent with those that had previously been set forth in the Notices, with the most significant exception relating to passthru payments.

With the release of the Joint Statement, the move towards a worldwide FATCA regime takes another step forward. This has created a significant amount of speculation both in and outside the United States regarding the requirements that ultimately will be included in these reciprocal agreements, and how they will be enforced. To date, U.S. withholding agents have been reporting information to the U.S. government regarding most types of U.S.-source income paid to foreign parties, identifying the home country of beneficial owners through the use of a country code on Form 1042-S. However, with the exception of Canadian beneficial owners, U.S. bank deposit interest generally is not subject to reporting. The fact that Treasury has now entered into this joint agreement committing in principle to reciprocation would seem to significantly increase the likelihood that the proposed regulations requiring reporting on nonresident bank deposit interest will be finalized. Moreover, these agreements may require a U.S. withholding agent to perform additional due diligence in order to verify the tax residence of the non-U.S. beneficial owners at the behest of other countries.

Included below are links to the proposed regulations, the press release, and the Joint Statement.

Link to release:

http://www.treasury.gov/press-center/press-releases/Pages/tg1412.aspx

Link to Joint Statement:

http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf

Link to regulations:

http://www.ofr.gov/OFRUpload/OFRData/2012-02979_PI.pdf

Entities in Scope

The Notices described certain classes of entities that potentially would either be exempt from FATCA withholding or have reduced obligations. The exceptions are based on either the business of the entity (for example, active NFFEs), the nature of the investors (for example, exempt beneficial owners or publicly traded NFFEs), or how or to whom their products are distributed (for example, limited to local banks or distributors restricted from distributing information or tax outside of their country of residence).

***PwC Observation**: By increasing the number of entity classifications exempt from withholding, the proposed regulations increase the complexity of the day-to-day account on-boarding processes. FFIs and withholding agents will need to collect the appropriate withholding certifications, statements, or documentary evidence for each classification, validate and store the information received, and determine when there is a reason to know there is a change in status or documentation has expired.*

Foreign Financial Institutions

The proposed regulations, consistent with the Act, continue to broadly define "financial institution." The proposed regulations expand the definition of a financial institution to include certain insurance companies, provide guidance on when an entity will be considered to be engaged in a banking business, and broaden the scope of investments subject to the "investing, reinvesting and trading" prong of the FFI definition to include notional principal contracts as well as insurance and annuity contracts. The definition of a financial institution in the proposed regulations therefore has been refined to include any entity that:

- Accepts deposits in the ordinary course of a banking or similar business;
- Holds financial assets for the account of others as a substantial part of its business;
- Is engaged (or holding itself out as being 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 (including a futures or forward contract or option) in any of the foregoing; or
- Is an insurance company (or the holding company of an insurance company) that issues or is obligated to make payments with respect to a financial account.

Consistent with comments in the Notices, the availability of deemed-compliant FFI status has been expanded to encompass more entities. Deemed-compliant FFI status has been divided into two primary classes -- registered deemed-compliant FFIs and certified deemed-compliant FFIs.

Registered deemed-compliant FFIs must register with the IRS and demonstrate adherence to procedural requirements. After registering on the IRS Web site, the FFI will receive an FFI employer identification number ("FFI-EIN"). Such an entity also must renew its status every three years. Registered deemed-compliant institutions include local FFIs, nonreporting members of participating FFI groups, qualified investment vehicles, and restricted funds. A registered deemed-compliant FFI also includes FFIs in countries that have entered into a FATCA agreement with the United States

Although these rules may make it easier for these types of entities to be deemed compliant, they will not eliminate the administrative burden associated with FATCA. For example, a restricted fund still will have to perform certain due diligence on direct investors and change how it does business with its distributors. If the distributor's FATCA status were to change, the fund will need to take remedial actions. Finally, a registered deemed-compliant FFI will be required to comply with rules regarding information gathering and monitoring procedures to certify its deemed-compliant status every three years.

> ***PwC Observation****: Treasury and the IRS have attempted to limit the application of FATCA to entities that pose a greater risk of facilitating U.S. tax evasion by U.S. persons. In most cases, a registered deemed-compliant FFI must meet several requirements toqualify for deemed-compliant status. Therefore, FFIs that have begun the process of evaluating their FATCA readiness now must evaluate each deemed-compliant category to determine if it may be subject to a lower level of FATCA compliance.*

The proposed regulations include a provision for adding additional categories of registered deemed compliant FFIs by future regulatory changes or by publication in the Internal Revenue Bulletin.

Certified deemed-compliant FFIs are not required to register with the IRS. Instead, eligible entities self-certify their deemed-compliant status directly to withholding agents (generally through the use of Forms W-8 or, in certain cases, other documentation). Certified deemed-compliant institutions include non-registering local banks, certain retirement plans, FFIs with only low-value accounts, and non-profit organizations. Each certified deemed-compliant FFI classification must meet specific eligibility and documentation requirements to qualify for certified deemed-compliant FFI status.

Exempt FFIs

Certain types of FFIs are exempt from FATCA withholding even though they technically fall within the definition of FFI. These FFIs, called "exempt beneficial owners," include:

- Foreign governments and their political subdivisions, agencies and instrumentalities;
- International organizations and their wholly owned agencies or instrumentalities;
- Foreign central banks of issue;
- Governments of United States possessions;
- Certain foreign retirement plans; and
- Certain entities wholly owned by one or more other exempt beneficial owners.

***PwC Observation**: While exempt FFIs are not subject to withholding on payments made to them, they still may be withholding agents on payments they make to others if those payments constitute withholdable payments. For example, a payment to a seller of a U.S. security is a withholdable payment that will require the exempt FFI to either obtain documentation from the seller evidencing that the seller is not subject to chapter 4 withholding or withhold 30 percent of the purchase price.*

NFFEs

A withholdable payment made to an NFFE generally is subject to withholding and reporting, unless the withholding agent can treat the beneficial owner as an NFFE that either does not have any substantial U.S. owners, or has identified its substantial U.S. owners. If the latter, the NFFE must supply certain information about its substantial U.S. owners to FFIs and withholding agents that, in turn, will report such information about these owners to the IRS. The proposed regulations provide exceptions from withholding for exempt beneficial owners that are consistent with those for an FFI, and also for publicly traded corporations and their affiliates.

The proposed regulations expand the exceptions to include a government of a U.S. territory and an active NFFE. An active NFFE is any NFFE if less than 50 percent of its gross income for the calendar year is passive income and less than 50 percent of its assets are assets that produce or are held for the production of dividends, interest, rents, and royalties (other than rents or royalties derived in the active conduct of a trade or business), annuities, or other passive income.

The FFI Agreement

For an FFI to be a participating FFI, the FFI must enter into an agreement ("FFI Agreement") with the IRS to become a participating FFI. Under the FFI agreement, a participating FFI will agree to determine the U.S. or non-U.S. status of its account holders, obtain appropriate information and documentation from account holders to support this classification, withhold on certain passthru payments made to recalcitrant account holders or non-participating FFIs, and report information on U.S. accounts to the IRS.

Each member of an FFI group must designate a lead FFI to initiate and manage the online registration process for the FFI group. The lead FFI that assumes this role will be required to electronically register itself and identify each FFI that is a member of the FFI group ("FFI members") that will register for participating, limited, or registered deemed-compliant FFI status.

In the preamble to the proposed regulations (the "Preamble"), Treasury and the IRS explain that they intend to publish a draft model FFI agreement in early 2012, and follow that with a final model FFI agreement in the fall of 2012 that will take into account comments that they receive with respect to the draft agreement. In addition, more information about the online registration process for FFI Agreements will be provided in future guidance.

> ***PwC Observation****: Although not specifically addressed in the proposed regulations, the Notices provided that an FFI must enter into an agreement with the IRS by June 30, 2013, to ensure that it will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014.*

Limited FFIs and Limited Branches

Under the Code and the Notices, each FFI in an expanded affiliated group must either enter into an agreement to become a participating FFI or obtain deemed compliant FFI status. This suggests that, when there is an expanded affiliated group that has an FFI member that is prohibited from complying with the provisions of FATCA (for example, a prohibition under local bank secrecy laws prohibiting the disclosure of account holder information), the entire expanded affiliated group (which may have hundreds or thousands of entities in dozens of countries) would be prevented from entering into an FFI Agreement. The consequence of this would be full withholding on withholdable and passthru payments made to any member of the group, even those that would have qualified for participating FFI status by entering into an FFI Agreement.

The proposed regulations address this problem by introducing the concept of "limited FFIs" and "limited branches." Under these rules, an FFI will be permitted to enter into an FFI Agreement even if another member of its expanded affiliated group cannot comply with all of FATCA's requirements, provided the noncompliant member meets certain conditions and requirements to be a limited FFI. Limited branches are similar to limited FFIs in that they are located in jurisdictions that prohibit compliance with one or more of FATCA's requirements. Limited status is available through the end of calendar-year 2015 and will enable the rest of the limited FFI's expanded affiliated group to enter into an FFI Agreement and prepare for complying with FATCA.

Limited FFIs are treated as nonparticipating FFIs and therefore subject to withholding on withholdable and passthru payments. In addition, limited FFIs are required to register with the IRS, perform due diligence on accounts as if they were participating FFIs, report under FATCA to the extent permitted by local laws, and agree not to open U.S. accounts or accounts for nonparticipating FFIs.

> ***PwC Observation**: It is not clear what will happen after December 31, 2015, for expanded affiliated groups with limited FFIs or limited branches that reside in countries whose laws have not been changed to permit compliance with FATCA (or entered into an agreement with the IRS to facilitate country-to-country reporting).*

Verification of Compliance

The proposed regulations clarify the scope and timing of the certifications required of a responsible officer of a participating FFI in regard to the completion of the participating FFI's compliance with its obligations under the agreement. Currently, the verifications are as follows:

- Within one year of the effective date of the FFI agreement, the responsible officer is required to certify to the IRS that:
  - The participating FFI has completed the review of all high value accounts; and
  - To the best of the responsible officer's knowledge, from August 6, 2011, until the date of certification, no formal or informal practices or procedures were in place to assist account holders in the avoidance of FATCA.
- Within two years of the effective date of the FFI agreement, the responsible officer is required to certify to the IRS that the participating FFI has completed the account identification procedures and documentation requirements for all financial accounts that are pre-existing obligations, and has either obtained the required documentation or treats such account in accordance with its FFI agreement.

A participating FFI will be required to conduct periodic reviews of its compliance with its FATCA policies and procedures. A responsible officer will periodically certify to the IRS the results of such reviews, and attest to the participating FFI's compliance with its FFI agreement. The responsible officer also may be required to provide certain factual information and to disclose material failures with respect to the participating FFI’s compliance with the requirements of its FFI Agreement.

> ***PwC Observation**: Industry has expressed significant concerns about the costs associated with certifying compliance with an FFI Agreement. The self-certification process for FATCA compliance outlined in the proposed regulations (and to be implemented in the FFI Agreement) is a welcome feature of these rules because, at a minimum, FFIs may choose to avoid the costs and other burdens associated with an external audit. Nevertheless, it should be noted that the IRS can require that an FFI retain an external auditor to verify FATCA compliance if the IRS has concerns about an FFI's compliance based on its self-certifications and other reporting.*

Financial Accounts

The definition of *financial account* has been refined in the proposed regulations to focus on traditional bank, brokerage and money market accounts, and interests in investment vehicles, and excludes most debt and equity securities issued by banks and brokerage firms.

Accordingly, *financial account* is defined as any depository or custodial account in a financial institution, certain equity or debt interests in a financial institution, and any cash value insurance and annuity contracts issued or maintained by a financial institution. A *U.S. account* is a financial account maintained by an FFI that is held by one or more specified U.S. persons or a U.S.-owned foreign entity.

Depository accounts are commercial, checking, savings, time, or thrift accounts, or accounts that are evidenced by a certificate of deposit, thrift certificates, investment certificates, certificates of indebtedness, or other similar instruments, along with any amount held by an insurance company under an agreement to pay or credit interest thereon.

Custodial accounts are accounts that are used to hold financial instruments or investment contracts for the benefit of another person and can include depository accounts, shares of stock in a corporation, notes, bonds, debentures, evidence of indebtedness, a currency or commodity transaction, a credit default swap, a swap based on a nonfinancial index, a notional principal contract, an insurance or annuity contract, any option, or other derivative instrument.

An *equity or debt interest* in a financial institution that is engaged primarily in the business of investing, reinvesting, or trading securities is a financial account if the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments.

Insurance contracts that include an investment component (cash value and annuity) and have a cash value greater than zero are financial accounts. Cash value means the greater of either the amount the policyholder is entitled to receive upon contract termination (without reductions for surrender charges or policy loans), or the amount the policyholder can borrow under the contract.

The proposed regulations also provide guidance on the treatment of a number of other debt and equity securities and the criteria they must satisfy to be excluded from financial account status. Among the most significant were:

- *Equity interests* that are regularly traded on an established securities market:
- *Non-life insurance contracts;*
- *Certain life insurance contracts* if equal periodic premiums are paid at least annually during the life of the contract and the amount payable upon contract termination (prior to death) does not exceed the aggregate premiums paid for the contract, less mortality, morbidity, and expense charges (even if not imposed) for the life of the contract;

- *Retirement and pension accounts* if the account is subject to government regulation as a personal retirement account or is registered as such, or is tax-favored, and annual contributions are limited to earned income, are from employers, governments, or employees, and are limited to $50,000 (except transfers); and

- *Non-retirement savings accounts* that are tax-favored and subject to government regulation, as long as annual contributions are limited to earned income, and are $50,000 or less, and penalties apply to early withdrawals and annual contributions exceeding $50,000.

Identification of the Payee

The proposed regulations generally provide that with respect to an account, the account holder is the payee. However, when the account holder is a participating FFI that is an intermediary or flow-through entity (other than a QI that has assumed primary withholding responsibility) or an NFFE acting as an intermediary, the parties for whom the intermediary or flow-through entity act are deemed to be the payee. Thus, the regulations adopt a look-through approach to FATCA that is similar to the current approach under the NRA withholding rules.

> ***PwC Observation****- This aspect of the proposed regulations is perhaps one of the more drastic departures from the Notices and the Code. This approach is beneficial in that it will better align FATCA withholding and reporting with NRA withholding and reporting. However, the obligation to pass withholding statements up to participating FFIs and withholding agents could be cumbersome when compared to treating the FFI itself as the payee, and may result in additional work on the part of a participating FFI. On the other hand, this burden may be mitigated somewhat by the ability to combine FATCA information with NRA withholding information (which must be provided up the chain in any case).*

FFI Account Due Diligence

A participating FFI generally is obligated under its agreement with the IRS to identify and document U.S. accounts and accounts held by foreign entities with substantial U.S. owners. Accounts in existence at the time the participating FFI's agreement becomes effective will be considered to be "pre-existing accounts," while accounts opened after the effective date will be considered to be "new accounts."

With respect to pre-existing accounts, the FFI must undertake certain steps to determine the status of its account holders and, when a U.S. account is identified, obtain a Form W-9 and a waiver (if necessary). In addition, an FFI that has documentation indicating an account is non-U.S. must obtain documentation to verify the status of that account if any U.S. indicia are found during its review.

With respect to new accounts, an FFI is required to review all information collected to open and maintain each account. The participating FFI is responsible for reviewing all documents to determine if the account holder has any U.S. indicia.

The proposed regulations generally adopt the same list of U.S. indicia as the Notices, with two changes. The proposed regulations add a U.S. telephone number as another type of indicia, while modifying the indicia of a standing instruction to transfer funds to an account maintained in the U.S. by removing "receiving directions from a U.S. address."

The proposed regulations also allow participating FFIs to leverage documentation collected under anti-money-laundering/know your customer (AML/KYC) procedures. The government indicated that reliance on existing AML/KYC procedures should reduce the number of changes to existing procedures required to implement a new account open system. Furthermore, by limiting the search of non-electronically-searchable information to customer master files and other specified documents, the proposed regulations reduce the burden of analyzing "all" available documents.

> ***PwC Observation**: By allowing organizations to rely more heavily on existing customer AML/KYC procedures, the proposed regulations appear to reduce the level of effort once projected for opening new accounts under FATCA. However, processes must be developed to monitor changes in circumstances. Specifically, participating FFIs must monitor accounts to discover indicia of U.S. status and account balances to determine if the due diligence procedures must be performed.*

Pre-existing individual accounts

The proposed regulations retain the option to treat as a non-U.S. account either a deposit account already documented as a U.S. account of less than $50,000 or any accounts not already documented as a U.S. account with a balance or value of less than $50,000 (subject to certain account aggregation rules). The proposed regulations also provide a $250,000 de minimis rule for a cash-value insurance or annuity contract. To the extent that an FFI's pre-existing accounts meet these de minimis tests, such accounts need not be reviewed again by the FFI unless and until the aggregate account balance exceeds $1,000,000.

For accounts that have a balance or value that exceeds $50,000 ($250,000 for a cash value insurance or annuity contract) but does not exceed $1,000,000, the FFI must perform a review of electronically searchable account data in an effort to determine whether the account has any indicia of U.S. status. An account has U.S. indicia if account information indicates that the account holder:

- Is known to be a U.S. citizen or resident;
- Was born in the United States.;
- Has a U.S. residence or mailing address;
- Has a U.S. telephone number;
- Has provided standing instructions to transfer funds to a U.S.-based account;
- Has granted power of attorney over the account to a person with a U.S. address; or
- Has a "care of" or hold mail address that is the sole address of the account holder.

If none of the above U.S. indicia are found, then no further search is required. However, when indicia of U.S. status are found, the FFI must follow up with the account holder and resolve the conflict by obtaining additional documentation (with the type of documentation that must be obtained varying based on the type of U.S. indicia found for an account). If the FFI cannot complete the electronic search with respect to its pre-existing individual accounts not previously identified as U.S. accounts and obtain the appropriate documentation within two years of the effective date of the FFI's agreement, it will be required to treat the account holder as recalcitrant.

The private banking requirements and the $500,000 threshold for high-value accounts outlined in the Notices have been replaced by enhanced due diligence processes for accounts with a balance or value that exceeds $1,000,000.

An accounts with a balance that exceeds $1,000,000 at the end of the calendar year preceding the effective date of an FFI's agreement, or at the end of any subsequent year, will be treated as a high-value accounts subject to enhanced due diligence review requirements. High-value accounts are subject to a review of electronic and non-electronic files for U.S. indicia, including an inquiry of the actual knowledge of the relationship manager associated with the account. Moreover, the proposed regulations provide more specific guidance on what documents need to be included in the diligent review (for example, the current customer master file). However, to the extent documents are not contained in the current customer master file, the following must be reviewed:

- The most recent documentary evidence (such as, a certificate of residence issued by an appropriate tax official, valid identification issued by an authorized government body, certain anti-money laundering documents, and third-party reports (for example, credit reports);
- The most recent account opening contract or documentation;
- The most recent documentation obtained by the participating FFI for AML purposes, due diligence, or for other regulatory purposes;
- Any power of attorney or signature authority forms currently in effect; and
- Any standing instructions to transfer funds currently in effect.

A participating FFI is required to perform an enhanced review of its paper files only to the extent the following information is not available in the FFI's electronically searchable information:

- The account holder's nationality and/or residence status;
- The account holder's current residence address and mailing address;
- The account holder's current telephone number(s);
- Whether there are standing instructions to transfer funds in the account to an account at another branch of the participating FFI or another financial institution;
- Whether there is a current "in care of" address or "hold mail" address for the account holder if no other residence or mailing address is found for the account; and
- Whether there is any power of attorney or signature authority for the account.

Thus, paper files are not required to be reviewed when the FFI has sufficient information in its electronically searchable information.

Finally, a participating FFI is not required to perform the enhanced review with respect to an account when the participating FFI has a Form W-8BEN and documentary evidence that establishes the foreign status of the account holder. However, the participating FFI is required to perform the relationship manager inquiry.

New individual accounts

With respect to accounts opened after the effective date of the FFI agreement, a participating FFI is required to review all account opening information collected

under its existing account opening procedures (including any documentation collected under AML/KYC rules) to determine whether any U.S. indicia exist. If U.S. indicia are found, the FFI must obtain additional documentation sufficient to establish the status of the account, or treat the account as held by a recalcitrant account holder.

Pre-existing entity accounts

Participating FFIs generally must perform a review of accounts held by entities. However, the proposed regulations provide that a pre-existing entity account with a balance of $250,000 or less is exempt from an initial due diligence review unless and until the account balance or value exceeds $1,000,000. With respect to remaining accounts, a participating FFI generally may rely on "AML due diligence" requirements and other existing account information to determine whether the entity is an FFI, U.S. person, excepted NFFE, or a passive investment entity (referred to in the regulations as a "passive NFFE").

In the case of pre-existing accounts of passive NFFEs with balances that do not exceed $1,000,000, participating FFIs generally are permitted to rely on information collected for AML due diligence purposes to identify substantial U.S. owners.

In the case of pre-existing entity accounts of passive NFFEs with account balances that exceed $1,000,000, participating FFIs must obtain either information regarding all substantial U.S. owners or a certification that the entity does not have substantial U.S. owners.

> ***PwC Observation**: It is expected that the number of passive NFFEs will be small and will include entities in the business of owning real estate and collecting passive rental income.*

New entity accounts

Participating FFIs must implement account opening procedures for entities. As accounts are opened, participating FFIs will be required to have procedures in place that will help identify U.S. accounts and substantial U.S. owners of U.S. owned foreign entities. As described in the process of account opening for new individual accounts, participating FFIs will be required to review and analyze new account opening documents. If indicia of U.S. status are discovered, additional documents must be collected. If additional documentation is not provided, the account must be treated as a recalcitrant account or as a non-participating FFI. The participating FFI must report and withhold on the account if the requested documents are not provided.

Certain types of entities are not required to identify their substantial U.S. owners. These are accounts held by other FFIs (other than an owner-documented FFI for which the participating FFI has agreed to perform reporting) and accounts held by entities engaged in active nonfinancial businesses. Other types of entities (essentially, passive investment entities), are required to identify substantial U.S. owners upon account opening by obtaining a certification from the account holder.

> ***PwC Observation**: Participating FFIs must develop systems that are flexible enough to associate many different account owners with the same account. This will be needed to accommodate multiple substantial U.S. owners of a non-U.S. entity. Some participating FFIs may be able to leverage any subaccount functionality currently being used.*

Change in Circumstances or Status

The proposed regulations provide that a change in circumstances will terminate the validity of a withholding certificate and that within 30 days, the withholding agent must be informed of the change and provided with a new certificate, a new written statement, or new documentary evidence. A certificate or other documentation also becomes invalid on the date that the withholding agent holding the certificate or documentation knows or has reason to know that circumstances affecting the correctness of the certificate or documentation have changed. However, a withholding agent has 90 days to obtain new documentation before changing the status of the account holder. A withholding agent may require a new certificate or additional documentation at any time prior to a payment, regardless of whether the withholding agent knows or has reason to know that any information stated on the certificate or documentation has changed.

Withholdable Payments

Generally, a withholding agent must withhold 30 percent on a withholdable payment made to a nonparticipating FFI or to a passive NFFE that fails to provide the required information with respect to its substantial U.S. owners. Similarly, a participating FFI must withhold on passthru payments made to recalcitrant account holders and non-participating FFIs.

There are two types of withholdable payments:

- U.S.-source FDAP income; and
- Gross proceeds from the sale of property that can produce U.S.-source dividends or interest.

Note that the sourcing rules for interest are modified for FATCA purposes such that interest paid on deposits held with a foreign branch of a U.S. bank is regarded as U.S.-source income.

The proposed regulations retain the transition periods for withholding provided in the Notices. Withholding begins on U.S.-source FDAP income on January 1, 2014, while withholding begins on gross proceeds from the sale of property that can produce U.S.-source dividends or interest on January 1, 2015. Although the definition of a foreign passthru payment was reserved in the proposed regulation, the proposed regulations provide that withholding on foreign passthru payments will begin no earlier than January 1, 2017.

Grandfathered Obligations

The proposed regulations expand the scope of grandfathered obligations by extending the applicable date from March 18, 2012, to January 1, 2013. Accordingly, payments made under an obligation outstanding on January 1, 2013 are not withholdable payments or passthru payments. In addition, gross proceeds from the sale or other disposition of a grandfathered obligation will be exempt from FATCA withholding.

> ***PwC Observation**: Although grandfathered obligations are not subject to FATCA withholding, it still may be necessary for an FFI to perform the appropriate due diligence and reporting for accounts in which grandfathered obligations are held.*

Consistent with the Notices, the proposed regulations do not include in the definition of a grandfathered obligation any interest in an entity that is treated as equity for U.S. tax purposes. In addition, any substantial modification of an obligation after January 1, 2013, will be treated as a re-issuance of the obligation on the date of the modification, taking the obligation out of grandfathered status.

> ***PwC Observation**: It appears that the definition of grandfathered obligation may be further expanded in final regulations. The IRS has requested comments on whether it is appropriate to treat as grandfathered obligations certain equity interests in securitization vehicles that invest solely in debt and similar instruments if such vehicles will liquidate within a specified time frame, given the types of investments they hold and the extent of their reinvestment in other assets.*

The proposed regulations do not address the status of FATCA obligations of servicers of securitization vehicles, collateralized debt obligations, and other complex debt instruments. However, the proposed regulations identify certain other obligations (such as debt instruments, revolver credit facilities, lines of credit, certain life insurance contracts, term-certain annuity contracts, and derivatives under an ISDA master agreement) as eligible for grandfathered status.

The proposed regulations also clarify that a payment on a grandfathered obligation made to a flow-through entity such as a partnership, simple trust, or grantor trust will retain its grandfathered status when paid by the flow-through entity to its partners, beneficiaries, or owners (as the case may be).

In addition to grandfathered obligations, the proposed regulations exclude the following types of payments from the definition of withholdable payments, and thereby from withholding:

Examples	Description
Certain short-term obligations	Payments of interest or original issue discount on short-term obligations (generally outstanding 183 days or less)
Effectively connected income	Income effectively connected with the conduct of a U.S. trade or business (unless exempted by an income tax treaty)
Ordinary course of business payments	Payments made in the ordinary course of the withholding agent's business for nonfinancial services, goods, and the use of property
Gross proceeds from sales of excluded property	Gross proceeds from the sale or other disposition of any property that can produce U.S.-source FDAP income excluded from the definition of withholdable payment
Sales of fractional shares	Sales of a fractional share of stock with gross proceeds less than $20

The proposed regulations also provide an exception to withholding when the withholding agent has no control over or custody of money or property owned by a payee or beneficial owner of a payment, or lacks knowledge of the facts giving rise to such payments (such as wire transfers out of deposit accounts).

Withholding Tax and Refunds/Credits

Similar to most of the provisions in the proposed regulations, the withholding requirements are phased in beginning in 2014 when withholding is required on U.S.-source FDAP income paid to recalcitrant account holders, prima facie FFIs, limited FFIs, limited branches, and documented nonparticipating FFIs. Withholding on gross proceeds begins in 2015. Finally, the withholding provisions are expected to be complete in 2017, when they will apply to foreign passthru payments.

Adjustments for overwithholding or underwithholding under FATCA generally are based on the procedures for addressing these situations under the NRA withholding rules. However, the definition of overwithholding and the timing of the reimbursement procedures differ.

Overwithholding is defined specifically as the amount actually withheld under FATCA that exceeds both the amount required to be withheld under FATCA and the actual tax liability of the beneficial owner of the income or payment under the NRA withholding rules. The withholding agent can repay the beneficial owner the amount of overwithheld tax and then reimburse itself by reducing the amount of tax deposited for a subsequent payment made before the end of the next calendar year. Repayment (but not the reimbursement) must occur before the due date of the Form 1042-S for the calendar year of the overwithholding or the date the withholding agent actually files the Form 1042-S with the IRS, whichever is earliest. The set-off procedure remains the same as under the NRA withholding rules, except that FATCA amounts may also be set off against amounts collected under NRA withholding rules.

> ***PwC Observation:*** *The IRS also has requested comments on the process for refunds on payments made to limited FFIs and limited branches so that it can consider safeguards to prevent abuse.*

Reporting

The proposed regulations impose a number of reporting requirements on withholding agents and participating FFIs, some of which are entirely new and some of which represent additions or modifications to existing reporting required under the NRA withholding regime.

Similar to FATCA's withholding provisions, the reporting requirements also will be phased in between 2014 and 2017. The phase-in of the reporting requirements will allow more time for withholding agents and participating FFIs to develop systems to comply with the requirements.

Generally, withholding agents must report information (on a yet-to-be determined form) regarding substantial U.S. owners of U.S.-owned foreign entities. In addition, withholding agents will be required to provide Forms 1042-S to the IRS and the payee to report certain amounts subject to FATCA withholding.

Participating FFIs generally have to report information with respect to U.S. account holders and substantial U.S. owners of U.S.-owned foreign entities. The Preamble notes that many FFIs already have implemented processes, procedures, and systems

to comply with Form 1042-S and 1042 reporting requirements, and that the IRS will modify the current 1042-S to meet the additional reporting requirements.

PwC Observation*- The IRS has requested comments with respect to the scope and ultimate implementation of withholding on foreign passthru payments. The definition of "foreign passthru payment" will be provided in future guidance and withholding on these payments is delayed until 2017. However, FFIs still will need to develop the processes, procedures, and systems to report these types of payments by January 1, 2015.*

The reporting requirements and implementation timelines for FFIs are as follows:

Calendar Year	Reporting Due	Reporting Requirement to U.S. Accounts[1]
2013	September 30, 2014	Required to report only name, address, TIN, account number, and account balance with respect to U.S. accounts identified as of June 30, 2014
2014	March 31, 2015	Required to report only name, address, TIN, account number, and account balance
2015	March 31, 2016	Required to report only name, address, TIN, account number, account balance, and income paid
2016	March 31, 2017	Required to report name, address, TIN, account number, account balance, income paid, and gross proceeds
2017	March 31, 2018	All of the reporting for calendar-year 2016 as well as foreign passthru payments

1 In the case of a U.S.-owned foreign entity, the information must be reported for the entity as well as the name, address, and TIN for each substantial U.S. owner.

The proposed regulations also simplify reporting requirements. FFIs will be allowed to report based on the originally denominated currency rather than in U.S. dollars.

PwC Observation*: Though the regulations are not entirely clear on the matter, it would appear that withholding agents will be required to perform similar reporting for payments made to U.S.-owned foreign entities. Specifically, the withholding agent would be required to report the name of the U.S.-owned foreign entity, as well as the name, address, and TIN of each substantial U.S. owner of the U.S.-owned foreign entity.*

Reporting on Noncompliant Accounts

A participating FFI must report the aggregate number and balance of recalcitrant accounts with U.S. indicia, recalcitrant accounts that do not have U.S. indicia, and dormant accounts.

In addition, a participating FFI also will need to report the amount paid to a non-participating FFI that is either foreign-source FDAP income or other financial payments for each of the calendar years 2015 and 2016.

> ***PwC Observation**: The proposed regulations reserve the definition of "other financial payments, The IRS has requested comments on the types of payments that should be included in this class of payments for purposes of this reporting requirement. This reporting is to provide a disincentive for non-participating FFIs to use participating FFIs to block the application of the chapter 4 rules.*

The participating FFI also must report withholdable payments made during the transitional period ending December 31, 2015, to limited branches.

Elective Reporting as a U.S. Financial Institution

In lieu of reporting account value and payment information on U.S. accounts as described above, a participating FFI may elect to report the information required to be reported on Forms 1099 as if it were a U.S. financial institution and each U.S. account holder is an individual citizen of the United States. For account holders that are U.S.-owned foreign entities, the participating FFI also must provide the name, address, and TIN of the entity, as well as the name address and TIN of each substantial U.S. owner of such entity.

In addition, participating FFIs that are U.S. payors (for example, controlled foreign corporations) that currently comply with chapter 61 reporting requirements (Forms 1099) for their U.S. accounts are deemed to comply with FATCA reporting requirements with respect to such U.S. accounts.

> ***PwC Observation:** This exception for participating FFIs that are U.S. payors that are already issuing Forms 1099 to their U.S. account holders will ease the compliance burden for these entities by reducing the system and process changes they will be required to make to become FATCA compliant. It also demonstrates the receptiveness of the IRS in some regard to concerns voiced by stakeholders regarding the need to simplify the FATCA compliance requirements.*

Conclusion

FATCA remains one of the most comprehensive and complex information reporting regimes in the world, and the Joint Statement indicates that other countries may soon follow the U.S. lead. During the next few months, we expect Treasury and the IRS to receive comment letters from institutions, industries, and other foreign governments. There have already been news reports of other governments supporting the Joint Statement, and Treasury and IRS still expect to issue the final regulations by the end of this year. PwC will issue additional Newsalerts and Newsbriefs as guidance is released.

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