

International Reporting & Withholding Subgroup

Foreign Account Tax Compliance Act (FATCA)

IRPAC has worked closely with the IRS and Treasury regarding the implementation of the Foreign Account Tax Compliance provisions of Subtitle A of Title V of the HIRE Act (commonly referred to as FATCA). IRPAC has engaged in an ongoing dialogue with the IRS and Treasury regarding the proposed regulations implementing FATCA that were issued on February 8, 2012,⁰ and the draft Forms W-8, Certificate of Foreign Status. IRPAC intends to continue this dialogue and provide input with regard to the regulations, associated forms, and the Foreign Financial Institution (FFI) registration process.

Following is a summary of the principal issues that have been discussed.

A. Preexisting Account Definition

Recommendation

IRPAC recommends that the definition of “preexisting obligation” in the proposed regulations be revised to mean any account, instrument, or contract maintained or executed by a withholding agent as of January 1, 2014. IRPAC also recommends that the final regulations clarify that the definition of a preexisting obligation includes any new subaccount opened for the same taxpayer.

Discussion

The proposed regulations define the term preexisting obligation to mean “any account, instrument, or contract maintained or executed by the withholding agent as of January 1, 2013.” With respect to a participating foreign financial institution (PFFI), however, a preexisting obligation is defined as one maintained or executed by the PFFI prior to the date that the PFFI’s agreement with the IRS becomes effective.¹ An FFI agreement will have an effective date of July 1, 2013 or later.² Thus, preexisting obligations of a U.S. withholding agent are those in existence on January 1, 2013, but the preexisting obligations of a PFFI are those in existence on June 30, 2013 (or prior to the later effective date of its FFI Agreement).

IRPAC submitted a comment letter on the definition of preexisting obligations, which is attached as Appendix H. In order to implement FATCA in an effective manner, it is critical that all withholding agents, including both U.S. and foreign financial

¹ Proposed Reg. § 1.1471-1(b)(48).

² Proposed Reg. § 1.1471-1(b)(24.)

institutions, be given sufficient time to make the numerous required changes to their computer systems and business intake procedures. The systems development process involves a series of steps. These steps include defining the scope of the project, development and documentation of technical requirements, finalization of programming changes, and scheduling the release of systems changes. Although preliminary scoping and initial design work can be undertaken based on the proposed regulations, the completion of design, programming and testing can only be accomplished after the regulations and associated forms are finalized. In order to provide withholding agents with the necessary lead time, IRPAC recommends that the definition of preexisting obligations be changed to those maintained or executed by a withholding agent as of January 1, 2014.

IRPAC also recommends that the final regulations clarify that the definition of a preexisting obligation includes any new subaccount opened for the same taxpayer.

Certain customers of financial institutions will open multiple accounts over various times to segregate funds and assets in order to meet investment objectives or compare investment returns. Systems have been built to identify the customer and the entire relationship by linking subaccounts contained within a common system that have been opened by that customer. Historically, no new tax certification has been required, provided existing documentation was current and valid. If a customer has an account that is a preexisting obligation, the establishment of a new subaccount for that customer should not be considered a new account that would change the classification of all of the customer's accounts. A new subaccount that is linked to a preexisting obligation should be considered a part of that preexisting obligation.

B. Reason to Know Standards

Recommendation

IRPAC recommends that the final regulations clarify that the reason to know standards included in the proposed regulations apply only to accounts found on a common computer system. That approach would be consistent with the current Chapter 3 standards for reliance on a certificate provided for another account and the identification of accounts for purposes of "B notice" and "C notice" withholding under Chapter 24.

Discussion

Financial institutions and other withholding agents often have multiple systems on which accounts are maintained based on each type of business or location. These systems generally are not linked together. If a customer opens a new account or updates an existing account by providing new tax certification documentation that is inconsistent with the information found on a separate computer system, that should not trigger the “reason to know” standard requiring reconciliation of all accounts throughout the entire organization.

The current regulations under Chapter 3 outline the situations where a financial institution can rely on a withholding certificate provided for another account of the same customer. Generally, it is permissible only when a “coordinated account information system” exists. In the absence of such a system, separate tax documentation must be obtained for each account of a customer.

Treasury Regulation § 31.3406(c)-1(c)(3)(ii) related to “C notice” research for accounts of the same customer provides:

Exercise of reasonable care. If an account identified pursuant to paragraph (c)(3)(i)(A) of this section contains a customer identifier that can be used to retrieve systemically any other accounts that use the same taxpayer identification number for information reporting purposes, the payer must identify all accounts that can be so retrieved. Otherwise, a payer is considered to exercise reasonable care in identifying accounts subject to withholding under § 3406(a)(1)(C) if the payer searches any computer or other recordkeeping system for the region, division, or branch that serves the geographic area in which the payee's mailing address is located and that was established (or is maintained) to reflect reportable interest or dividend payments.

Treasury Regulation § 31.3406(d)-5(c)(3)(ii) related to “B notice” research for accounts provides similar rules for identification of accounts of the same customer.

IRPAC believes that the rationale for the current standards for identification of accounts provided for in the Treasury Regulations under Chapter 3 and Chapter 4 is applicable in the Chapter 4 context.

C. FFI Verification Process

Recommendation

IRPAC recommends that verification of a participating FFI be based primarily on the FATCA identification number (FATCA ID), that the number of data elements be limited and that the name of an FFI be considered a match if it is reasonably similar to the name on the IRS list. In addition, any annual verification process should allow withholding agents with the flexibility to choose the date for performing the verification.

Discussion

Proposed Regulation § 1.1471-3(d)(3) states a withholding agent must verify the FFI-Employee Identification Number (EIN) against a published IRS list of FFI numbers, as described in proposed regulation § 1.1471-3(e)(3).³ Subsequent announcements by the IRS have revised the references in the proposed regulations to clarify that the verification will be to the FATCA ID rather than the FFI-EIN. The applicable Forms W-8 will require a participating FFI and registered deemed compliant FFI to include its FATCA ID on the Form W-8 (or state that it applied for a number). The withholding agent must verify that the number is valid by its inclusion on the IRS published list within ninety calendar days from the date the claim is made. Thereafter, the withholding agent must verify the FATCA ID has not been removed from the IRS published list on a periodic basis because the withholding agent can no longer treat a claim as a participating FFI or register deemed compliant FFI as valid “on the earlier of the date that the withholding agent discovers that the FFI has been removed from the list or the date that is one year from the date the FFI’s name was actually removed from the list.”

Historically, matching to names of entities has proven to be difficult. Many entity names are lengthy and may be very similar to names of other entities.

³ (3) FFI-EIN--(i) In general. A withholding agent that has received a payee’s claim of status as a participating FFI or registered deemed-compliant FFI has reason to know that such payee is not such a financial institution if the payee’s name and FFI-EIN do not appear on the most recent published IRS FFI list within 90 calendar days of the date that the claim is made. A payee whose registration with the IRS as a participating FFI or a registered deemed-compliant FFI is in process but has not yet received an FFI-EIN may provide a withholding agent with a Form W-8 claiming the chapter 4 status it applied for and writing “applied for” in the box for the FFI-EIN. In such case, the FFI will have 90 calendar days from the date of its claim to provide the withholding agent with its FFI-EIN and the withholding agent will have 90 calendar days from the date it receives the FFI-EIN to verify the accuracy of the FFI-EIN against the published IRS FFI list before it has reason to know that the payee is not a participating FFI or registered deemed-compliant FFI. If an FFI is removed from the list of participating FFIs and registered deemed-compliant FFIs published on the IRS database, the withholding agent knows that such FFI is not a participating FFI or registered deemed-compliant FFI on the earlier of the date that the withholding agent discovers that the FFI has been removed from the list or the date that is one year from the date the FFI’s name was actually removed from the list.

For example, it is not unusual for investment funds to have related funds with similar names such as:

ABC Growth Fund Class A Shares
ABC Growth Fund Class B Shares

Entities will also frequently abbreviate their names, for example:

XYZ Banking Group, Limited
XYZ Banking Group, Ltd.

There are many other possibilities where the name on a Form W-8 may differ from the name on the IRS published list, but will be the same entity. If the FATCA ID matches and the name on the Form W-8 and the IRS published list are reasonably similar, the regulations should provide that the withholding agent may treat the FATCA ID as verified.

The proposed regulations require withholding agents to verify the FATCA ID after the account has been opened and also confirm that it has not been removed from the IRS list at a later date. It is anticipated that very few FFIs will drop off the FATCA ID list. For this reason, IRPAC believes the annual verification may be an unnecessary burden. Verification on an annual basis determined by the account opening date of each account, which is implied in the regulations, would be expensive and cumbersome. If the final regulations retain the annual verification process, withholding agents should be allowed flexibility in determining the date chosen to perform the verification.

D. Presumption Rules for Certain Exempt Recipients

Recommendation

IRPAC recommends that an entity that may be treated as an exempt recipient without the need for furnishing a Form W-9, Request for Taxpayer Identification Number and Certification, an “eyeball exempt recipient”, should not be presumed foreign unless there are indicia of foreign status associated with the entity’s account.

Discussion

Proposed regulation § 1.1471-3(f)(3)(ii) provides that certain eyeball exempt recipients (e.g. corporations, financial institutions, and brokers) will be presumed foreign if the withholding agent has not received a Form W-9 from the recipient. This represents

a change from long standing rules under Chapter 3 and Chapter 61. The rationale for this change is unclear. IRPAC believes that in the absence of foreign indicia associated with an account of an eyeball exempt recipient, there should not be a presumption of foreign status.

For purposes of Chapter 3, Treasury Regulation § 1.1441-1(b)(3)(iii)(A) provides that an eyeball exempt recipient is presumed to be a foreign person only if:

- (1) the withholding agent has actual knowledge of the payee's employer identification number and the number begins with the two digits 98; or
- (2) the withholding agent's communications with the payee are mailed to an address in a foreign country; or
- (3) the name of the payee indicates that it is a type of entity on the per se list of foreign corporations; or
- (4) payment is made outside the U.S.

IRPAC believes that the above indicia of foreign status should also apply for purposes of presuming the foreign status of an eyeball exempt recipient for Chapter 4 purposes.

E. Ordinary Course of Business Payments

Recommendations

IRPAC recommends that all payments made in the ordinary course of business for services be excluded from the definition of withholdable payments under Chapter 4.

Discussion

Proposed regulation § 1.1473-1(a)(4)(iii) provides that payments made in the ordinary course of a withholding agent's business for nonfinancial services are excluded from the definition of a withholdable payment. This is an appropriate and welcome exclusion. Payments for services, as opposed to payments of investment income, are the type of payment that represents a very low risk of tax evasion. However, it is unclear how a withholding agent should distinguish between payments for financial services and nonfinancial services. For example, a payment for investment advisory or management services might be considered a payment for financial services. However, such payments would generally be subject to withholding under Chapter 3 if the services are performed in the U.S. It is unlikely that U.S. persons would provide such services through a foreign entity. IRPAC believes that payments for services, whether for

financial services or nonfinancial services, made in the ordinary course of business should be excluded from the definition of withholdable payment under Chapter 4.

F. Model Intergovernmental Agreements

Recommendation

IRPAC recommends that branches of U.S. financial institutions and controlled foreign corporations (CFCs) not be subject to reporting requirements applicable to financial institutions subject to an Intergovernmental Agreement (IGA).

Discussion

The model IGAs appear to include in the definition of FATCA Partner Financial Institution (as defined in the model IGA) a branch of a U.S. financial institution (USFI) located in the FATCA Partner, as well as a CFC resident in the FATCA Partner. As a result, it is possible that such branches and CFCs may be subject to reporting obligations to the FATCA Partner. Any such reporting obligation would be duplicative of reporting obligations already imposed on branches of USFIs and CFCs under Chapter 3, Chapter 4 and Chapter 61. IRPAC believes that the final regulations under Chapter 4 and the terms of an IGA entered into with a FATCA Partner should provide that a branch of a USFI and a CFC will only be subject to reporting to the IRS.

G. New Forms W-8BEN

Recommendations

IRPAC reviewed and discussed with the IRS the early release draft versions of the new Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (Individual), and Form W-8BEN-E, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (Entities). IRPAC recommends that the IRS make text and formatting changes to the Form W-8BEN-E in order to:

- (1) clarify who should use the form,
- (2) ensure entities submitting the form make the correct Chapter 4 status selections, and
- (3) streamline the overall amount of information collected and submitted.

The objective of such recommendations is to reduce the potential for errors by those completing the forms and, therefore, decrease the number of invalid Forms W-8BEN-E submitted to withholding agents.

IRPAC also recommends that the IRS delay the required effective date for the use of new Forms W-8 until January 1, 2014. This will allow withholding agents to begin using the new forms when their systems and procedures are sufficiently prepared, but no later than January 1, 2014.

Discussion

IRPAC is pleased that the IRS adopted the recommendation included in the 2011 IRPAC Annual Report that there be two separate versions of the Form W-8BEN - one for individuals and one for entities. The early release draft versions of the new Form W-8BEN and Form W-8BEN-E circulated in June 2012, confirmed this approach and provided the global financial services industry with valuable insight into the additional information they will be required to capture for purposes of fulfilling their documentation obligations under Chapter 4. However, due to the complexity of the proposed regulations, the Form W-8BEN-E is long and complicated. IRPAC is concerned that many people will be confused by the terminology used on the form which, combined with the length and complexity of the form, will lead to a high rate of errors on forms being submitted to withholding agents.

IRPAC discussed with the IRS a number of specific changes to the Form W-8BEN-E, including the following:

- In the instructions at the top of the form, clarify which entity types should use the Form W-8BEN-E for claiming treaty benefits (rather than using a Form W-8EXP, Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding);
- Remove references to “Chapter 3” on Line 3 and “Chapter 4” on Line 4, since these may be confusing to those persons completing the form who may have little or no understanding of U.S. tax law nomenclature;
- Remove the “Not applicable” reference in the Line 4 check box for use by entities submitting the form solely for purposes of documenting their foreign status for Merchant Card Reporting under IRC § 6050W, since again this may be confusing to those persons unfamiliar with the Internal Revenue Code and may in fact encourage people to select this status as a default if they do not know their true Chapter 4 status;
- Include a direction at the bottom of the first page that other pages of the form must also be completed and the form must be signed on page 6.

- Remove Part II, Notional Principal Contracts, since in practice this line item is rarely used by those persons submitting the existing version of Form W-8BEN; and,
- Remove the Capacity line in Part XXIV, consistent with the approach taken by the IRS on the draft Forms W-8ECI, Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States and W-8EXP.

In addition, IRPAC made a number of suggestions regarding the validation rules for financial institutions when reviewing and validating new Forms W-8, including:

- Allow a tolerance based on a "reasonable person" standard, for the use of country abbreviations on Lines 2, 5 and 6; and,
- Allow the withholding agent to accept and retain on its systems only the specific pages of the Form W-8 that pertain to the particular payee. For example, a PFFI would only need to submit pages 1, 2 and 6 of the Form W-8BEN-E.

IRPAC impressed upon the IRS the importance of publishing final versions of the new Forms W-8 (including the Forms W-8IMY, W-8EXP and W-8ECI) along with instructions as soon as possible in order to allow financial institutions the necessary time to update (or build in the case of FFIs who are not U.S. payers) and integrate their systems. In its 2011 Annual Report, IRPAC noted that typically a withholding agent needs 18 to 24 months in order to update its systems appropriately (including time to develop business requirements and systems logic, and then to code and test those systems). Without final forms, withholding agents cannot finalize this process. Given the January 1, 2013 implementation date in the proposed regulations for new account documentation requirements for USFIs, the delay in publishing final forms will severely impede the ability of USFIs to meet these requirements. IRPAC believes it would be better to allow withholding agents more time by delaying the required effective date for using the new Forms W-8 so that they can "do it right" rather than impose unrealistic timeframes that inevitably will cause widespread and unintended non-compliance. Delaying the required effective date for the use of the new Forms W-8 until January 1, 2014, will provide withholding agents with the flexibility to come "on-line" when they are ready, while still retaining a mandatory deadline for compliance.

H. Coordination of Chapter 3 and Chapter 4

Recommendation

IRPAC has discussed with the IRS the need for the regulations under Chapter 3 and Chapter 4 to be coordinated. Specifically, IRPAC has recommended that the IRS issue regulations or other guidance that address the Chapter 3 issues discussed in the 2011 IRPAC Public Report.

Discussion

The 2011 IRPAC Public Report included a discussion of several Chapter 3 withholding tax issues. These issues will be of equal importance under Chapter 4.

Following is a summary of those issues.

Capacity: The determination of whether the capacity of a person who executes a Form W-8BEN for an entity should be considered valid has been an issue for U.S. withholding agents for many years. IRPAC recommends that the IRS issue guidance to the effect that a U.S. withholding agent may treat a person who has executed a Form W-8BEN for an entity as an authorized representative or officer of the entity regardless of the person's title shown on the Form W-8BEN. IRPAC also recommends that the Instructions to the Form W-8BEN be revised to state that an authorized representative means a person who is authorized to sign on behalf of the beneficial owner based on authority granted to that person in, for example, organizational documents, resolutions (or similar documents) or laws applicable to the beneficial owner.

Permanent Residence Address: The instructions to the current Form W-8BEN state that the Permanent Residence Address (Line 4) of the beneficial owner should not be the address of a financial institution, a post office box, or an address used solely for mailing purposes. The only address of many offshore investment funds is that of a registered agent or investment advisor. IRPAC recommends that the IRS issue guidance on the acceptability of such an address and the type of additional documentation, if any, that is required to validate the form.

Reason for U.S. Address: Current Treasury Regulations require a withholding agent to obtain a reasonable explanation in writing from a payee who provides a Form W-8 with a U.S. address. IRPAC recommends that the IRS issue guidance that the reasonable explanation in writing may be furnished either in a letter from the payee or by a form provided by the withholding agent specifically for this purpose. A form

provided by a withholding agent could identify common reasons for a non-U.S. person to have a U.S. address on the Form W-8.

Inconsequential Errors in Documentation: During the course of an IRS withholding tax examination, a variety of errors may be identified on Forms W-8. Some of these errors should clearly invalidate the form because they may impact the reliability of the form itself (e.g. missing information required by the regulations or form instructions, or uncured due diligence issues). However, other detected errors may be minor in nature, and generally should not impact the reliability of the data on the form. IRPAC recommends that the IRS issue guidance stating that errors that do not impact the status of the payee and do not impede withholding agents from processing the Form W-8 correctly should be considered inconsequential in nature, and should not cause the form to be invalid.

Use of copies/faxed/e-mailed Forms W-8: IRPAC met with the IRS and discussed the disparity in standards required under current guidance for the receipt of Forms W-8 and Form W-9. Specifically, withholding agents may accept Form W-9, Request for Taxpayer Identification Number and Certification, via fax, e-mail, or other soft-copy format, but may only rely on Forms W-8 in original hard-copy format. IRPAC recommends that the IRS issue guidance allowing withholding agents to rely on copies of Forms W-8 (including those received via fax, e-mail or other similar forms of electronic transmission) if the form is otherwise facially valid.

Use of retroactive Forms W-8 with affidavits: The IRS has stated publicly that forthcoming guidance on the Chapter 3 withholding issue will curtail the current industry practice of obtaining retroactive Forms W-8 to cure undocumented accounts, including documents received when the withholding agent is under examination, by requiring the provision of additional documentation establishing the account holder's status in some circumstances. IRPAC discussed with the IRS the issue of when it is appropriate for withholding agents to rely on retroactive Forms W-8 both with and without an accompanying affidavit of unchanged status. IRPAC recommends limiting any change in current accepted practices to be applied prospectively, to payments made on or after January 1, 2013 (assuming the guidance is released prior to that date). IRPAC also recommends that a requirement to obtain additional documentation be limited to cases where a withholding agent has not obtained a Form W-8 prior to the time a payment is made to a payee.

IRPAC notes that the proposed regulations under Chapter 4 address the use of retroactive Forms W-8 and certain circumstances under which electronic Forms W-8 may be accepted. IRPAC also notes that the drafts of the revised Form W-8ECI and

Form W-8EXP no longer have a line for capacity, although there is a box to check confirming the signer of the form has the capacity to sign on behalf of the entity for which the form is furnished. IRPAC believes this is a major improvement and urges the IRS to also remove the capacity line from the W-8BEN-E when that form is finalized.

I. Short-Term Debt

Recommendation

FATCA generally imposes withholding and reporting obligations with respect to “withholdable payments.” The definition of withholdable payment includes U.S. source interest (including original issue discount), but does not provide an explicit exception for interest or original issue discount on short-term debt. Similarly, FATCA imposed reporting requirements with respect to “financial accounts.” The 2011 IRPAC Public Report recommended that interest (including original issue discount) on debt having a term of 183 days or less be excluded from the definitions of withholdable payment and financial account under FATCA, consistent with Congressional intent and with the long-standing exemption from withholding under Chapter 3.

Discussion

IRPAC is pleased to note that the proposed regulations exclude from the definition of withholdable payment under Chapter 4 interest (including original issue discount) on debt having a term of 183 days or less. IRPAC continues to believe that such interest (including original issue discount) should be excluded from the definition of a financial account under FATCA.