SHEARMAN & STERLING LLP

TAX | CLIENT PUBLICATION

January 25, 2013

Final FATCA Regulations Issued

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Contacts

Laurence M. Bambino
New York
+1.212.848.4213
lbambino@shearman.com

Roger J. Baneman
New York
+1.212.848.4894
rbaneman@shearman.com

Peter H. Blessing
New York
+1.212.848.4106
pblessing@shearman.com

Douglas R. McFadyen
New York
+1.212.848.4326
dmcfadyen@shearman.com

Lawrence M. Hill
New York
+1.212.848.4002
lawrence.hill@shearman.com

Ansgar A. Simon
New York
+1.212.848.8781
ansgar.simon@shearman.com

Laurence E. Crouch
Palo Alto
+1.650.838.3718
lcrouch@shearman.com

The Treasury Department (the "Treasury") issued on January 17, 2013 Final Regulations implementing the Foreign Account Tax Compliance Act or FATCA. The Final Regulations make some material changes to the regulations proposed in 2012 and establish new effective dates for the implementation of the rules.

FATCA[1] was enacted in 2010 in order to reduce perceived offshore tax evasion by US persons holding assets through offshore accounts that were not subject to US information reporting to the Internal Revenue Service (the "IRS"). For this purpose, FATCA generally requires a foreign payee of a withholdable payment (as defined below) to provide certain information to the withholding agent. In addition, a foreign payee that is a foreign financial institution (an "FFI") is generally required either (1) to enter into an agreement with the IRS relating to such reporting (an "FFI Agreement") or (2) to comply with local laws that implement an intergovernmental agreement (an "IGA") relating to FATCA between its country and the United States. If a foreign payee does not satisfy the requirements, withholdable payments are subject to withholding at a rate of 30%. FATCA information reporting and withholding requirements generally do not apply to FFIs that are treated as deemed-compliant because they present a relatively low risk of being used for tax evasion or that are otherwise exempt or excepted from FATCA withholding.

This memorandum highlights important changes in the Final Regulations from the proposed regulations, which were described in our memorandum "Key Aspects of the FATCA Regime" from May 2012. A separate, more detailed memorandum is forthcoming that will more thoroughly summarize the FATCA requirements in light of the Final Regulations.

[1] FATCA is contained in Section 1471 through 1474 of the Internal Revenue Code (the "Code").

Contacts (cont.)

Kristen M. Garry
Washington, DC
+1.202.508.8186
kgarry@shearman.com

Craig Gibian
Washington, DC
+1.202.508.8034
cgibian@shearman.com

Don J. Lonczak
Washington, DC
+1.202.508.8080
dlonczak@shearman.com

Michael B. Shulman
Washington, DC
+1.202.508.8075
mshulman@shearman.com

Delayed Effective Dates for Certain Withholding

Withholdable payments include (1) US source interest, dividends, and other fixed or determinable annual or periodical ("FDAP") payments; (2) gross proceeds from the taxable disposition of property that produces US source interest or dividends; and (3) "foreign passthru payments," which generally are payments that are made by an FFI that has entered into an FFI Agreement and that are attributable to withholdable payments. Pursuant to the Final Regulations, withholding will apply (other than with respect to grandfathered obligations, as described below):

- beginning January 1, 2014 for interest, dividends, and other FDAP payments;
- beginning January 1, 2017 for payments of gross proceeds; and
- beginning no earlier than January 1, 2017 for foreign passthru payments.

Expansion of Grandfathering

FATCA withholding will not apply to "grandfathered obligations." These include any obligation (not including equity instruments) outstanding on January 1, 2014 that is not materially modified thereafter. In addition:

- if a debt obligation is issued after December 31, 2013 pursuant to a "qualified reopening" of a debt instrument issued before January 1, 2014, such debt will be grandfathered;
- grandfathering will apply to payments in respect of any collateral to the extent it is posted pursuant to an agreement to provide security with respect to one or more grandfathered obligations;
- an obligation that gives rise to a dividend equivalent pursuant to Section 871(m) of the Code (treating payments in respect of certain equity derivatives as dividends) will be grandfathered if issued within six months after the date when obligations of its type are first treated as giving rise to dividend equivalents; and
- for purposes of "foreign passthru payments," any obligation will be grandfathered if executed within six months after the date when final regulations first provide a definition of that term.

FFI Agreement Procedures

The Final Regulations make changes to the FFI Agreement procedures and outline the process for entering into an FFI Agreement with the IRS.

FATCA Registration Portal and GIINs. The preamble to the Final Regulations outlines the process for FFIs (and relevant US withholding agents) to register as a participating FFI or registered deemed-compliant FFI and to enter into, to comply with, and to maintain their FFI Agreement. The IRS intends to establish an electronic "FATCA Registration Portal," which it aims to make accessible to financial institutions starting no later than July 15, 2013. The Portal will allow appropriate registration for FFIs in countries with which the Treasury

has entered into an IGA (as described below) even if the necessary ratification of the IGA by the partner country has not yet been completed. Prior to opening the Portal, the Treasury and the IRS will publish a revenue procedure with the terms and conditions applicable to FFIs for FATCA purposes.

Once a financial institution has registered, the IRS has to approve the registration and to issue a "global intermediary identification number" (a "GIIN"). Assignment of GIINs is intended to begin no later than October 15, 2013. The IRS intends to publish a monthly electronic "IRS FFI List" of participating FFIs and registered deemed-compliant FFIs (including reporting FFIs in Model 1 IGA countries (see below)) starting December 2, 2013. An FFI should register at the Portal no later than October 25, 2013 to be included in the first IRS FFI List.

Due Diligence. For purposes of the due diligence obligations of a participating FFI, a financial account will be treated as a "pre-existing account" if it is in existence on December 31, 2013, even if the FFI enters into an FFI Agreement before that date. Unless an account holder or payee is a *prima facie* FFI, participating FFIs and withholding agents have until December 31, 2015 to review pre-existing accounts and to document their holders. Pre-existing accounts held by individuals with a balance or value of no more than $50,000 (or $250,000 in the case of cash value insurance and annuity contracts)[2] are exempt from this review. Also, in reviewing pre-existing accounts with a balance or value of no more than $1,000,000, a participating FFI may (in lieu of obtaining certification) rely on a search of electronically searchable account information and, if the account is held by a passive non-financial foreign entity (an "NFFE"), on its review of anti-money laundering due diligence to identify substantial US owners of the payee.

For financial accounts held by an entity, an FFI's ability to rely on the entity's self-certification as to the entity's FATCA status has been expanded.

Account Reporting. The due date for the first information report required to be filed by participating FFIs (which will relate to the 2013 calendar year) has been extended to March 31, 2015. The information report with respect to 2014 is also due on that date.

Integration of Regulations with Intergovernmental Agreements

Since the Treasury issued the proposed regulations under FATCA, it has developed in collaboration with several foreign governments two alternative IGA models. IGAs allow foreign governments to implement FATCA in a manner that removes legal impediments to compliance in the relevant foreign country (e.g., bank secrecy laws) and that reduces compliance burdens on FFIs. The Final Regulations integrate the statutory FATCA regime with the IGA structure.

Both IGA models require FFIs that are located in the relevant foreign jurisdiction (and that are not exempt or excepted from FATCA compliance pursuant to the IGA) to identify and report information about US accounts.

The Model 1 IGA (published July 26, 2012, modified on November 14, 2012) provides that FFIs located in the IGA partner country identify US accounts pursuant to due diligence rules adopted by the partner country and report specified information to the relevant governmental authorities of the partner country. The information is then automatically exchanged by the partner country with the IRS, aiming at providing the same quality and quantity of information as the IRS would receive from a participating FFI under an FFI Agreement. An FFI in a Model 1 IGA country that complies with

[2] Insurance contracts with a value of no more than $50,000 will not be treated as financial accounts.

its local due diligence and reporting requirements will be treated as a registered deemed-compliant FFI – i.e., it will still be required to obtain a GIIN.

Under the Model 2 IGA (published November 14, 2012), the FATCA partner country agrees to direct and enable all FFIs located in the jurisdiction (and not exempt or excepted from FATCA compliance pursuant to the Model 2 IGA) to register with the IRS and to report specified information about US accounts directly to the IRS. For recalcitrant account holders that do not provide information required under FATCA to the FFI, information reported to the IRS is supplemented by a government-to-government exchange of information.

To date, Denmark, Ireland, Mexico, Norway, Spain, and the United Kingdom have signed or initialed a version of the Model 1 IGA. The Treasury has stated that it is looking to conclude IGAs with more than 50 countries. Thus, there is an expectation that a number of additional IGAs will be concluded with FATCA partner countries in the coming months.

Changes to Definitions

The Final Regulations contain several important changes and clarifications to critical definitions affecting the scope of FATCA.

Disregarded Entity as Holder of Account. The Final Regulations clarify that an account held by a disregarded entity is treated as held by the owner of the entity.

Financial Accounts. Financial accounts include depository accounts, custodial accounts, certain debt and equity instruments issued by an FFI, and certain life insurance and annuity contracts.

The Final Regulations clarify that a depository account is an account for the placing of money in the custody of an entity engaged in a banking or similar business, including a credit balance with respect to a credit card account. The definition specifically excludes (1) any negotiable debt instrument that is traded on regulated or over-the-counter markets and distributed through financial institutions and (2) any escrow account established for commercial transactions.

The Final Regulations exclude from the definition of financial account debt or equity interests in (1) investment advisors or asset managers and (2) holding companies and treasury centers of expanded affiliated groups whose aggregate income is derived primarily from active NFFEs, depository institutions, custodial institutions, and insurance companies, unless the interest tracks the performance of one or more investment entities or its value is determined primarily by reference to assets that give rise (or could give rise) to withholdable payments.

The Final Regulations also exclude additional savings vehicles from the definition of financial account, including:

- tax-favored retirement or pension accounts with an annual contribution limit of $50,000 or a life-time contribution limit of $1,000,000, regardless of whether the contributions are made only by the government, the employer, or the employee; and
- other tax-favored savings vehicles with limitations on conditions for withdrawal and an annual contribution limit of $50,000.

Financial Institutions. The Final Regulations clarify when depository institutions and investment entities are treated as financial institutions.

- To qualify as a depository institution, an entity must, in addition to accepting deposits, also engage on a regular basis in one or more other enumerated banking or financing activities. Entities that accept deposits only as collateral or security

pursuant to a lease, loan, or similar financing arrangement or that make money transfers will not be considered depository institutions.

- The definition of investment entity reflects the development of IGAs by limiting a financial institution status for investment entities to those that undertake activity on behalf of customers. An investment entity is defined as one that primarily conducts as a business on behalf of customers (1) trading in an enumerated list of financial instruments; (2) individual or collective portfolio management; or (3) otherwise investing, administering, or managing funds, money, or certain financial assets on behalf of other persons. Passive foreign entities that are not professionally managed are generally treated as passive NFFEs (and not as FFIs), unless they hold themselves out as collective investment vehicles, hedge funds, mutual funds, or similar investment vehicles.
- Holding companies, treasury centers, and captive finance companies that are not depository or custodial institutions and are members of a nonfinancial group are generally not financial institutions.

Fund Sponsor Complying for its Funds. The Final Regulations add to the categories of registered deemed-compliant FFIs any investment entity that is not a withholding partnership or trust, or a qualified intermediary, if another entity has agreed to act as its "sponsoring entity." A sponsoring entity is one that is authorized to manage the investment entity and to enter into contracts on its behalf (e.g., a fund manager or managing partner), has registered with the IRS as a sponsoring entity, has registered the investment entity with the IRS, and has agreed to perform, on behalf of the investment entity, all due diligence, withholding, reporting, and other requirements that the investment entity would have been required to perform if it were a participating FFI.

Refunds

The Final Regulations provide that a participating FFI and a reporting Model 1 IGA FFI may file a collective refund claim on behalf of account holders and payees subject to FATCA overwithholding if certain conditions and procedural requirements are satisfied.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069