Practical Guide to Implementing FATCA for Nonfinancial Institutions

Sheri Wilcox, Tax Controversy and Risk Management Services, Ernst & Young LLP

Todd Larsen, Information Reporting and Withholding Services, Ernst & Young LLP
Disclaimer

► Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited located in the US.

► This presentation is © 2013 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of US and international law. Ernst & Young and its member firms expressly disclaim any liability in connection with use of this presentation or its contents by any third party.

► The views expressed by panelists in this presentation are not necessarily those of Ernst & Young LLP.
Circular 230 disclaimer

► Any US tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state or local tax law provisions.

► These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Today’s agenda

► FATCA introduction and fundamentals
► Requirements of a USWA as payor
► Global legal entity classification
► Foreign Financial Institutions
► What should US multi-nationals do now?
Today’s agenda

► FATCA introduction and fundamentals
► Requirements of a USWA as payor
► Global legal entity classification
► Foreign Financial Institutions
► What should US multi-nationals do now?
What is FATCA?

- The Foreign Account Tax Compliance Act (FATCA) is a 2010 US tax law designed to identify US taxpayers who may be evading US taxation by investing in offshore investment vehicles or foreign accounts.

- FATCA introduces new documentation standards, information reporting and compliance requirements for all entities as payors.

- FATCA is generally effective on 1 January 2014, but with phased in effective dates for various specific requirements.

- Foreign Financial Institutions (FFIs) will be required to enter into agreements with the IRS to become “participating FFIs” or they may be subjected to new withholding requirements.

- FATCA imposes a 30% withholding tax on certain US-connected payments made to entities that choose not to participate in FATCA and payees who refuse to be documented.
FATCA’s impact on multi-nationals

► FATCA applies to all entities, impact on each entity will vary based on footprint and business lines

► FATCA presents financial risks and operational challenges for most companies

► FATCA will impact US entities as payors and multi-national entities as both payors and payees

► 30% withholding tax applies to noncompliant organizations and recalcitrant account holders

► Failure to comply with FATCA will make it difficult to do business with other compliant institutions

► FATCA will impact business operating models from vendor onboarding to operations and compliance

► The identification of affected payors and payees must be accomplished quickly to enable an effective communication strategy and action plan
FATCA fundamentals

► Expansive new reporting and withholding rules aimed at ensuring that US persons with financial assets outside the US pay their US tax

► Reporting focus is on ultimate shareholders/owners

► FATCA categorizes entities as
  ► US entities - US withholding agents (USWAs)
  ► Foreign entities - foreign financial institutions (FFIs) and non-financial foreign entities (NFEFs)
    ► FFIs are generally required to enter into agreements with the IRS to perform substantial due diligence, information reporting and withholding on their account holders or suffer 30% withholding on payments made to them
    ► NFEFs must to certify as to “substantial” US owners or suffer 30% withholding

► Phased in effective dates, beginning 1 January 2014
FATCA vs existing law

- FATCA is an additional reporting and withholding regime that will apply before the existing NRA/section 1441 regime, but many of the concepts will converge.

- NRA vs. FATCA – generally,
  - Existing NRA rules are aimed at withholding US tax and reporting of US source fixed or determinable, annual or periodical (FDAP) income paid to non-US persons.
  - FATCA is not designed to impose a withholding tax, but rather is designed to capture information about US persons. Withholding generally only applies if there are payments to:
    - NFFEs that fail to either identify and disclose substantial US owners or certify they have no substantial US owners, OR
    - Nonparticipating (or presumed nonparticipating) FFIs
Today’s agenda

► FATCA introduction and fundamentals
► Requirements of a USWA as payor
► Global legal entity classification
► Foreign Financial Institutions
► What should US multi-nationals do now?
For US withholding agents making payments, four general steps are necessary:

**Step 1:** Determine whether a payment is a “withheld payment,” (i.e., FDAP and gross proceeds, with certain exceptions)

**Step 2:** If the payment is a withheld payment, determine its source

**Step 3:** If the withheld payment is US source (or applicable gross proceeds), determine the status of payee as US or foreign (and if foreign, the entity’s FATCA classification) with documentation (generally, Form W-8 or W-9)

**Step 4:** Withhold and report, if required

These same steps are generally

- Applicable to withholding agents both inside and outside of the US, and
- Applicable regardless of whether the withholding agent and payee are related (i.e., intercompany payments)
USWA as payor
- Step 1: Identify withholdable payments

► FATCA introduces the term “withholdable payment”, which includes:
  ► FDAP income (defined as under 1441 rules) that is US source, and
  ► Gross proceeds from the disposition of property that can produce interest or dividends that are US source FDAP (i.e., sale of US securities)

► FDAP (fixed or determinable, annual or periodical) income generally includes interest, dividends, rents, royalties, compensation for services, premiums, annuities and most other types of gain, profit, and income unless excepted

► FATCA regulations provide for certain exclusions such as specified “non-financial” payments

► A withholding agent must carefully track the types of payments being made to identify its FATCA requirements
Withholdable payment types include:

- Bank and brokerage fees
- Investment advisory fees
- Custodial fees (e.g., fund manager fees)
- Payments in connection with lending transactions
- Forward, futures, option or notional principal contracts
- Premiums for insurance contracts or annuity contracts and amounts paid under cash value insurance or annuity contracts
- Dividends on US securities
- Interest (with certain exclusions including interest paid on obligations held 183 days or less)
- Original issue discount (excludes obligations held 183 days or less)
- Dividend equivalent payments where the USWA acts as custodian
- Certain lease payments (i.e., financing leases)
USWA as payor
- Step 1: Identify withholdable payments (cont’d)

► Certain types of payments are specifically excluded from the FATCA definition of “withholdable payment”. These include:
  ► Payments for tangible goods, and
  ► Excluded nonfinancial payments

► Examples of payment types that are excluded:
  ► Fees paid for nonfinancial services (e.g., litigation fees paid for a personal injury dispute or fees paid to an engineering consultant)
  ► Software licenses
  ► Interest on outstanding bills arising from services
  ► Rent for office space
  ► Use of property (e.g., royalty or intellectual property)
  ► Freight/transportation expenses
  ► Interest on deferred purchases (e.g., goods purchase on credit)
  ► Lease payments on equipment
USWA as payor  
- Step 2: Determine source of payment

- FATCA requirements generally only exist for FDAP that is US source or gross proceeds from US securities. Foreign source income is generally excluded from FATCA requirements

- Source must be able to be determined
  - Processes should include documenting source of income where necessary
  - Review all documents and information necessary to determine source of income including contracts, invoices and knowledge of those involved in the transactions
  - Where source is not known, presumption rules require treatment as US source

- Test current processes and procedures to ensure they determine source properly and timely (before payment is made) and that source is documented

- Update processes and systems as necessary
USWA as payor
- Step 3: Determine status of payee

► For a USWA, FATCA only applies to payments made to non-US entities
   ► Note: For an FFI, FATCA applies to payments made to non-US entities and individuals

► Based on documentation and other information about a payee receiving a withholdable payment subject to FATCA, determine:
   ► Status of payee as individual or entity
   ► Then, if entity, status of payee as US or non-US
   ► Then, if non-US entity, FATCA classification of payee (i.e., FFI, NFFE)
   ► Follow additional requirements depending on FATCA classification, such as:
     ► If NFFE, generally must receive certification regarding substantial US owner information. If not, withhold at 30%
     ► If FFI, generally must receive certification as participating FFI (subject to certain exceptions) and verify such status with IRS. If not, withhold at 30%

► New, more complex withholding certificates (Forms W-8) and documentation requirements will necessitate more detailed processes, procedures and controls
In the absence of documentation, FATCA presumption rules must be applied.

FATCA presumption rules are complex and generally result in the payee being a non-participating FFI, on whom withholding at 30% is required.

- The “eyeball test” to determine US exempt recipient status is very limited under FATCA. Therefore, most US payees must furnish a Form W-9 to document their status. This represents a significant change from current law.

FATCA also adds due diligence for new categories of US indicia of non-US payees.

Where applicable, Chapter 3 and Chapter 61 regulations are expected to conform to FATCA by 31 December 2013. This is expected to include presumption rules, due diligence for US indicia and other applicable documentation requirements.

Test current processes for determining payee status and make adjustments and additions as necessary to take new FATCA requirements into account.

FATCA will necessitate careful tracking of information and validation of documentation (e.g., identify changes in circumstances and expiration dates).
USWA as payor  
- Step 4: Withhold and report, if required

► Generally, if all payees are compliant, no withholding will be required for FATCA purposes

► However, withhold 30% on withholdable payments made to non-compliant payees (vendors, customers and/or accountholders), i.e., non-participating FFIs and non-certifying NFFEs

► Withholding is required on withholdable payments to non-compliant payees (vendors, customers and/or accountholders) beginning on 1 January 2014, with phased in effective dates

► For example, US source interest paid on 5 January 2014 to an NFFE that has not provided the required certification regarding its substantial US owners (typically on a Form W-8BEN-E) must be subjected to 30% withholding

► However, for “pre-existing obligations” a withholding agent is generally not required to impose withholding on US source FDAP until 1 January 2016 (unless the payee is a “prima facie” FFI

► Also, payments on “grandfathered obligations” are excepted from FATCA unless there is a material modification to the obligation
USWA as payor
- Step 4: Withhold and report, if required (cont’d)

- A USWA generally must report information about substantial US owners of NFFE when are not excepted NFFE, to the extent such information is received from the payee or the USWA knows or has reason to know the information.

- The information listed below must be reported to the IRS on or before 31 March of the calendar year following the year in which the withholdable payment was made to an NFFE with substantial US owners, as follows:
  - Name of the NFFE
  - Name of each substantial US owner
  - TIN of each substantial US owner
  - Address of each substantial US owner, and
  - Any other information as required by the designated form and its accompanying instructions.
Today’s agenda

- FATCA introduction and fundamentals
- Requirements of a USWA as payor
- Global legal entity classification
- Foreign Financial Institutions
- What should US multi-nationals do now?
Global legal entity classification

► A multi-national organization must classify its entities under FATCA for two main purposes:

1) To provide appropriate documentation and information to payors from whom the entity receives withholdable payments, thereby avoiding consequences such as:
   ► Withholding at 30%
   ► Negative effects on flow of business, flow of income and business relationships
   ► Potential scrutiny by IRS and/or local government

2) To determine whether the entity is a withholding agent under FATCA, and the type (e.g., FFI, USWA), so that it can fulfill its responsibilities as a withholding agent. For example:
   ► A Foreign Financial Institution (FFI) generally must register with the IRS and perform certain due diligence with respect to identifying and reporting US accountholders
   ► A US withholding agent generally must identify withholdable payments to non-US entities, obtain documentation and report substantial US owners
Global legal entity classification - US entities / US withholding agents

- With these purposes in mind, a multi-national organization must classify its entities into three general categories, as follows:
  - US entities / US withholding agents
  - Foreign Financial Institutions (FFIs)
  - Non-Financial Foreign Entities (NFFEs)

- A US entity must generally provide a Form W-9 to payors to document itself as a US person
  - In the absence of a Form W-9, most US entities will be presumed foreign for FATCA purposes and will be subject to withholding at 30%

- An FFI must generally provide a Form W-8BEN-E with a US Global Intermediary Identification Number (GIIN)

- An NFFE must generally provide a Form W-8BEN-E and a certification with respect to substantial US owners
Global legal entity classification
- Foreign Financial Institutions (FFIs)

► A financial institution for FATCA purposes is broadly defined and generally includes the following:
  ► An entity that accepts deposits in the ordinary course of a banking or similar business
  ► An entity that holds, as a substantial portion of its business, financial assets for the benefit of one or more other persons (custodial institution), or
  ► An investment entity, which is generally defined as:
    ► An entity that primarily conducts the business of trading in various financial instruments, managing individual or collective portfolios, or otherwise investing, administering, or managing funds (defined broadly), money or financial assets on behalf of other persons
    ► An entity that functions as a fund (defined broadly) or which gross income is primarily attributable to investing, reinvesting or trading in financial assets
  ► Certain insurance companies, holding companies or treasury centers that are members of an expanded affiliated group having specified attributes
Global legal entity classification
- Exclusions from FFI status

- Certain entities that may otherwise meet the definition of a “financial institution” under FATCA may be excluded from the definition if:
  - The entity is a
    - Nonfinancial holding company: primary purpose is to own (in whole or in part) the outstanding stock of one or more subsidiaries that engage in a trade or business, provided that no such subsidiary is a financial institution;
    - Treasury center: function is to enter into investment, hedging and financing transactions with or for members of its expanded affiliated group (EAG) in order to manage risk of interest rate, price and currency fluctuations and other functions; or
    - Captive finance company: primary activity is to enter into financing / leasing transactions with suppliers, distributors, and customers of any active NFFE member of the EAG, and
  - Certain other requirements are met
    - An expanded affiliated group generally has a 50% ownership threshold
    - The non-financial group test generally looks to levels of passive income and requires a 3-year look-back. It can be complex to apply.
Global legal entity classification  
- Non-Financial Foreign Entities (NFFEs)

- An NFFE is defined as a non-US entity that is not a financial institution
- A withholding agent is required to withhold 30% of any withholdable payment made to a payee that is an NFFE unless:
  - The USWA has appropriate certifications regarding substantial US owners of the NFFE, and
  - The USWA reports to the IRS required information about any substantial US owners
   or
  - The NFFE is an “excepted” NFFE (certification generally required). For example:
    - A publicly traded entity (per FATCA definition) and its affiliates
    - An active NFFE
To effectively administer FATCA around the world, the US Treasury is entering into intergovernmental agreements with various countries to enable local country administration and certain changes to FATCA requirements that the US government deems appropriate based on local country considerations.

These can alter FATCA entity classifications within a local jurisdiction. For example:

- The regulations provide that for entities resident in IGA countries, the IGA definitions of FFI and NFFE control, and that the statutory and regulatory definitions apply to entities that are resident in jurisdictions that do not enter into IGAs.

- IGAs of certain countries have their own unique list of excepted and deemed compliant entity types, based on the risk profiles of those entity types within the relevant country.

- IGAs also have specific guidance regarding documentation an FFI can collect to determine the classification of a payee.
Today’s agenda

► FATCA introduction and fundamentals
► Requirements of a USWA as payor
► Global legal entity classification
► Foreign Financial Institutions
► What should US multi-nationals do now?
Foreign Financial Institutions

► To avoid 30% withholding on withholdable payments it will receive as a payee, an FFI must generally enter into an agreement with the IRS to become a Participating FFI (PFFI)

► The agreement requires the PFFI to:
  ► Obtain information on individual and legal entity account holders to determine the account holder is a US person, recalcitrant individual, NPFFI, PFI, NFFE, etc.;
  ► Comply with verification and due diligence procedures to identify US accounts;
  ► Report information on US accounts and recalcitrant account holders;
  ► Deduct and withhold 30% on certain payments to recalcitrant individual account holders and non-participating FFIs (NPFFIs);
  ► Comply with IRS requests for additional information; and
  ► Obtain a waiver of any applicable bank secrecy or other information disclosure limitations from a US account holder or close their account;
Foreign Financial Institutions (cont’d)

- Electronic FFI Agreement submissions are expected to begin 15 July 2013 for FFI Agreements (FFIAs) with effective dates of 31 December 2013.

- Documentation procedures for new accounts generally required to begin 1 July 2014. Pre-existing obligations have phased in effective dates.

- Required to review all documentation collected with respect to account opening or maintenance of an individual account holder, including AML/KYC documentation, for US indicia.

- Indicia of US status includes: a US place of birth, a US telephone number as sole contact number, POA or signatory authority granted to a person with a US address and standing instructions to transfer funds to an account in the US.
Today’s agenda

- FATCA introduction and fundamentals
- Requirements of a USWA as payor
- Global legal entity classification
- Foreign Financial Institutions
- What should US multi-nationals do now?
What should multi-nationals do now?

Corporate Footprint
- Define and review organizational footprint
- Review entities within the corporate footprint and identify each legal entity’s FATCA classification (USWA, FFI, NFFE, etc.)
- For each entity, identify documentation to be provided to a payor

Payment streams
- Identify business units making and processing payments and review FATCA implications
  - Accounts Payable, Treasury, Shareholder Relations and any other function involved in payment processing and determination of income (e.g., procurement, legal and business units).
- Review impact on intercompany transactions as well as third-party payments

Current IRW compliance capabilities
- Review current information reporting and withholding compliance
- Identify process and procedure gaps that may delay or derail FATCA compliance efforts
Questions?