The Foreign Account Tax Compliance Act: An End to Bank Secrecy?

The Foreign Account Tax Compliance Act (FATCA) is poised to dramatically alter the landscape for U.S. taxpayers maintaining offshore bank accounts. Bank secrecy jurisdictions will no longer be able to provide the protection and anonymity they previously offered, as FATCA will require foreign financial institutions to annually disclose the names of their U.S. accountholders to the Internal Revenue Service or face a 30 percent withholding tax. The now-issued final regulations impose significant compliance obligations, and foreign banks and withholding agents should begin immediate preparations for the new information reporting regime required by FATCA. Taxpayers with undisclosed offshore bank accounts should also prepare for the implementation of FATCA by taking immediate steps to rectify their non-compliance.

IAN M. COMISKY AND MATTHEW D. LEE

For the past five years, the U.S. government has waged an unprecedented global campaign to crack down on the use of secret, offshore bank accounts by U.S. taxpayers to evade taxes. While there is nothing illegal about maintaining accounts in foreign countries, U.S. taxpayers are required annually to disclose their offshore accounts to the Internal Revenue Service on a form entitled “Report of Foreign Bank and Financial Accounts”—commonly known as the FBAR form—and to report all income generated by those holdings on their personal income tax returns. The failure to report foreign accounts can subject a taxpayer to hefty civil penalties and, in the case of willful conduct, criminal prosecution. Since 2009, nearly 40,000 U.S. taxpayers have come forward under special IRS voluntary disclosure programs to reveal that they have unreported bank accounts in countries such as Switzerland, India, Israel, and many others. During the same time period, the U.S. Department of Justice has brought criminal charges against 60 individual account holders and a substantial number of “enablers,” including bankers, attorneys, and investment advisors.

Despite the large numbers of individuals who have participated in the various IRS voluntary disclosure programs over the past four years, it is nonetheless widely believed that many more U.S. taxpayers holding foreign accounts in countries around the world have failed to “come in from the cold,” largely due to the belief that the U.S. government will never discover the existence of their accounts. Many of these account holders presumably believe that they are protected by the bank secrecy laws of the countries where they maintain accounts or that those jurisdictions would never willingly give up the names of account depositors. But that is all about to change, as key provisions of the Foreign Account Tax Compliance Act (FATCA) are rolled out in the coming months.

The primary focus of FATCA is to identify non-compliance by U.S. taxpayers using offshore accounts. Once implemented, FATCA will require foreign financial institutions (a broadly defined term that includes traditional banks but also encompasses a broad array of non-bank financial institutions such as hedge funds) to annually disclose information about accounts held by U.S. individuals or foreign companies in which

Ian M. Comisky is a former federal prosecutor and a partner at Blank Rome LLP in Philadelphia. Mr. Comisky may be reached at Comisky-im@blankrome.com. Matthew D. Lee is a former U.S. Department of Justice trial attorney and a partner at Blank Rome LLP in Philadelphia. Mr. Lee may be reached at Lee-m@blankrome.com. Both have significant experience in FATCA compliance and frequently advise both U.S. investors and foreign financial institutions as to their obligations under FATCA and the Final Regulations.
U.S. individuals hold a substantial ownership interest. Foreign financial institutions which refuse to provide such information about their customers to the U.S. will face a stringent penalty: withholding of 30 percent of all U.S.-source payments of interest, dividends, and the like. FATCA essentially forces foreign banks to cooperate if they wish to have access to U.S. capital markets, and will substantially penalize banks, and the countries in which they are resident, that refuse to participate.

**FATCA STATUTORY PROVISIONS**

FATCA, which was enacted by Congress in 2010 as part of the Hiring Incentives to Restore Employment Act, added Chapter 4 of Subtitle A of the Internal Revenue Code, and new Sections 1471 through 1474. Chapter 4 generally requires U.S. withholding agents to withhold tax on certain payments to foreign financial institutions (FFIs) that do not agree to report certain information to the IRS regarding their United States accounts, and on certain payments to certain nonfinancial foreign entities (NFFEs) that do not provide information on their substantial United States owners to withholding agents.

**Section 1471.** Section 1471(a) requires any withholding agent to withhold 30 percent of any “withholdable payment” to an FFI that does not meet the requirements of Section 1471(b). A withholdable payment generally includes:

- Any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income (FDAP income), if such payment is from sources within the United States; and
- Any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.\(^1\)

An FFI is broadly defined as any financial institution that is a foreign entity, and a “financial institution” is similarly defined broadly to include any entity that:

- Accepts deposits in the ordinary course of a banking or similar business;
- At a substantial portion of its business, holds financial assets for the account of others; or
- Is engaged primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.\(^4\)

An FFI meets the requirements of Section 1471(b) if it either (1) enters into an FFI agreement with the IRS to perform certain obligations or (2) meets requirements prescribed by the Treasury Department and the IRS to be deemed to comply with the requirements of Section 1471(b).

An FFI that enters into an FFI agreement with the IRS is considered to be a “participating FFI” and is required to identify its “U.S. accounts” and comply with verification and due diligence procedures prescribed by Treasury. A “U.S. account” is generally defined as any financial account held by one or more “specified United States persons” or “United States owned foreign entities.” A U.S.-owned foreign entity is defined as any foreign entity that has one or more substantial U.S. owners. The requirements of the FFI agreement apply to the U.S. accounts of the participating FFI and also to the U.S. accounts of any other FFI that is a member of the same “expanded affiliated group.”

FATCA requires a participating FFI to report certain information on an annual basis to the IRS with respect to each U.S. account maintained at its institution.\(^5\) The information that must be reported with respect to each U.S. account includes: (1) the name, address, and taxpayer identifying number of each account holder who is a specified U.S. person (or, in the case of an account holder that is a U.S. owned foreign entity, the name, address, and TIN of each specified U.S. person that is a “substantial U.S. owner” of such entity); (2) the account number; (3) the account balance or value; and (4) the gross receipts and gross withdrawals or payments from the account. If foreign law would prevent the FFI from reporting the required information absent a waiver from the account holder, and the account holder fails to provide a waiver within a reasonable period of time, the FFI is required to close the account.\(^6\)

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\(^1\) P.L. 111-147, 124 Stat. 71 (2010).
\(^2\) Unless specifically indicated otherwise, “Section” references appearing in the body of the text are references to sections of the Internal Revenue Code of 1986, as amended (the “Code” or “IRC”).
\(^3\) IRC § 1473(1).
\(^4\) IRC § 1471(b)(1)(C), (E).
\(^5\) IRC § 1471(b)(1)(D).
\(^6\) IRC § 1471(d)(5).
\(^7\) IRC § 1471(b)(1)(A), (B).
\(^8\) IRC § 1471(e).
\(^9\) IRC § 1471(d)(1).
\(^10\) IRC § 1471(d)(1)(F).

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FATCA further requires a participating FFI to withhold 30 percent of any “passthru payment” to a “recalcitrant account holder” or to an FFI that does not meet the requirements of Section 1471(b) (referred to as a “nonparticipating FFI”). A “passthru payment” is defined as any withholdable payment or other payment to the extent attributable to a withdrawable payment. A “recalcitrant account holder” refers to any account holder that fails to provide the information required to determine whether the account is a U.S. account, or the information required to be reported by the FFI, or that fails to provide a waiver of a foreign law that would prevent reporting.

Section 1472. Section 1472 addresses U.S.-source payments made to NFFEs, which are defined as any foreign entities that are not financial institutions. FATCA requires a withholding agent to withhold 30 percent if the payment is beneficially owned by the NFFE or another NFFE, unless the requirements of Section 1472(b) are met with respect to the beneficial owner of the payment. Section 1472(b) requirements are met with respect to the beneficial owner of a payment if:

- The beneficial owner or payee provides the withholding agent with either a certification that such beneficial owner does not have any substantial U.S. owners, or the name, address, and TIN of each substantial U.S. owner;
- The withholding agent does not know or have reason to know that any information provided by the beneficial owner or payee is incorrect; and
- The withholding agent reports the information provided to the IRS.

PRELIMINARY GUIDANCE ISSUED BY THE IRS
Since the passage of FATCA by Congress in 2010, Treasury and the IRS have issued several sets of preliminary guidance on the implementation of chapter 4. On February 15, 2012, Treasury and IRS published proposed regulations for implementation of the FATCA statutory provisions, and on October 24, 2012, released Announcement 2012-42 which stated that certain provisions of the proposed regulations would be amended when final regulations were promulgated.

Following issuance of the proposed regulations, Treasury and the IRS received significant comments from interested stakeholders. The bulk of the concerns focused on the costs and burdens associated with FATCA implementation and legal hurdles to compliance posed by foreign law. A public hearing was held on May 15, 2012, at which further comments were received by Treasury and IRS.

POLICY UNDERLYING FATCA
It is important to understand that despite its withholding provisions, FATCA is not intended to be a revenue-generating law. Instead, FATCA is primarily an information-reporting regime, imposing reporting obligations on foreign financial institutions in order to provide the IRS with additional data regarding the foreign activities of U.S. taxpayers. To that end, the preamble to the Final Regulations states as follows:

U.S. taxpayers’ investments have become increasingly global in scope. FFIs now provide a significant proportion of the investment opportunities for, and act as intermediaries with respect to the investments of, U.S. taxpayers. Like U.S. financial institutions, FFIs are generally in the best position to identify and report with respect to their U.S. customers. Absent such reporting by FFIs, some U.S. taxpayers may attempt to evade U.S. tax by hiding money in offshore accounts. To prevent this abuse of the U.S. voluntary tax compliance system and address the use of offshore accounts to facilitate tax evasion,

13 IRC § 1471(b)(1)(D)(i).
14 IRC § 1471(d)(7).
15 IRC § 1471(d)(6).
16 IRC § 1472(a).
17 The other two statutory provisions are IRC §§ 1473 and 1474. Section 1473 provides the definitions of key terms and Section 1474 sets forth a series of special rules for FATCA withholding.
it is essential in today’s global investment climate that reporting be available with respect to both the onshore and offshore accounts of U.S. taxpayers. This information reporting strengthens the integrity of the U.S. voluntary tax compliance system by placing U.S. taxpayers that have access to international investment opportunities on an equal footing with U.S. taxpayers that do not have such access or otherwise choose to invest within the United States.\(^{19}\)

**RELEASE OF THE FINAL REGULATIONS**

On January 17, 2013, Treasury and IRS issued a massive set of final regulations spanning 543 pages.\(^{20}\) In a press release announcing the release of the Final Regulations, Treasury stated that

> These regulations give the Administration a powerful set of tools to combat offshore tax evasion effectively and efficiently. The final rules mark a critical milestone in international cooperation on these issues, and they provide important clarity for foreign and U.S. financial institutions.\(^{21}\)

In attempting to address compliance concerns expressed by stakeholders, the Final Regulations state that Treasury and the IRS “carefully considered these comments and established three avenues for addressing the principal concerns regarding burdens, legal impediments, and technical implementation.”\(^{22}\) First, the Final Regulations utilize a risk-based approach to implementing FATCA. Second, the Final Regulations allow for collaboration with foreign governments to develop an alternative intergovernmental approach to streamline FATCA implementation and compliance. Third, the Final Regulations attempt to simplify the process for registering and entering into an FFI agreement with the IRS in order to minimize operational costs associated with collecting and reporting FATCA information. In the following sections, we summarize key provisions in the Final Regulations and their implications for foreign governments, FFIs, NFFEs, withholding agents, and individual taxpayers.

**FFI AGREEMENT AND FFI REGISTRATION PROCESS**

The Final Regulations describe all of the substantive requirements applicable to an FFI under an FFI agreement, including withholding requirements with respect to recalcitrant account holders and nonparticipating FFIs, identification and documentation of U.S. accounts, annual reporting of U.S. accounts, verification of compliance with FATCA requirements, events of default, and the process for seeking refunds of withheld amounts.\(^{23}\) In addition, the Final Regulations do not restrict a participating FFI’s ability to terminate an FFI agreement. Treasury and the IRS have said that they expect to publish a revenue procedure setting out the terms of an FFI agreement in the near future.\(^{24}\) The Final Regulations also delay the effective date of the FFI agreement until December 31, 2013, for all participating FFIs that receive a Global Intermediary Identification Number (GIIN) prior to January 1, 2014.\(^{25}\)

**Web-Based Registration and Reporting.** The Final Regulations provide that an Internet-based FATCA Registration Portal will be the primary means for financial institutions to interact with the IRS to complete and maintain their Chapter 4 registrations, agreements, and certifications. The Portal will be accessible to financial institutions worldwide beginning no later than July 15, 2013. The IRS has also published a draft Form 8957, entitled “Foreign Account Tax Compliance Act (FATCA) Registration,” which sets forth in paper format the questions that FFIs will be required to answer as part of the online registration process.\(^{26}\)

**Issuance of GIINs.** Once a financial institution has registered, the IRS will approve its registration and will issue a GIIN to each participating FFI and

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\(^{19}\) Final Regulations, Preamble, Background Part II.


\(^{22}\) Final Regulations, Preamble, Background Part IV.

\(^{23}\) Treas. Reg. § 1.1471-4.

\(^{24}\) Final Regulations, Preamble, Procedural Matters Part I.A.

\(^{25}\) Treas. Reg. § 1.1471-1(b)(31). GIIN refers to the identification number that will be assigned to each participating FFI or deemed-compliant FFI. The IRS will publish a list containing the names and GIINs for all participating FFIs, registered deemed-compliant FFIs, and reporting Model 1 FFIs. See Treas. Reg. § 1.1471-1(b)67).

\(^{26}\) The draft Form 8957 is available on the IRS website at http://www.irs.gov/pub/irs-utl/13f8957.pdf.
registered deemed-compliant FFI. GIINs will be assigned beginning no later than October 15, 2013, and should be used as the institution’s identifying number for satisfying its reporting requirements and identifying its status to withholding agents.

The IRS will electronically post the first list of participating FFIs and registered deemed-compliant FFIs (including reporting Model 1 FFIs) on December 2, 2013.\footnote{27 The IRS has posted “FFI List Schema and Test Files” on its website as an example of the type of information that will be contained in the FFI List once it is finalized and published. See http://www.irs.gov/Businesses/International-Businesses/IRS-FFI-List-Schema-and-Test-Files.} Withholding agents may rely on an FFI’s claim of FATCA status based on checking the payee’s GIIN against the published FFI List. This list will be updated monthly after December 2013.

Planning reminder: The last date by which a financial institution can register with the IRS to ensure its inclusion on the December 2013 IRS FFI List is October 25, 2013.

**NON-FINANCIAL FOREIGN ENTITIES**

The Final Regulations provide that if a foreign entity is not considered an FFI, the entity will be deemed a “Non-Financial Foreign Entity” or NFFE.\footnote{28 Treas. Reg. § 1.1471-1(b)(74).} Certain categories of NFFEs are not required to register with or report to the IRS, and are not subject to withholding, because they are deemed to present a low risk of tax evasion. The Final Regulations expand the definition of NFFEs to include passive entities that are not professionally managed as well as financial institutions and certain passive NFFEs that are part of a nonfinancial group of companies and support the operations of the group.

Specifically, the Final Regulations define two types of NFFEs which are exempt from withholding under FATCA:

- **Excepted NFFEs**, which includes publicly traded companies; and
- **Active NFFEs**, which are NFFEs with less than 50 percent passive income.\footnote{29 Treas. Reg. § 1.1472-1(c)(1)(ii), (iv).}

The regulations provide that an NFFE which is not an “Excepted NFFE” or an “Active NFFE” will have to provide its withholding agent with information on any substantial U.S. owners, or if none exist, a certification to that effect.

TARGETED DUE DILIGENCE REQUIREMENTS TO DISCOVER U.S. ACCOUNTS

The Final Regulations also attempt to reduce the burdens imposed on FFIs to identify U.S. accounts in several ways. First, all preexisting accounts held by individuals with a balance or value of $50,000 or less are entirely exempt from review.\footnote{30 Treas. Reg. § 1.1471-5(a)(4)(i).} The exemption threshold is raised to $250,000 for preexisting accounts held by entities and for preexisting accounts that are cash value insurance and annuity contracts.\footnote{31 Treas. Reg. § 1.1471-4(c)(5)(iv)(B).} Further, in the case of preexisting accounts with a balance of $1 million or less, the Final Regulations permit a participating FFI to determine whether any of such accounts held by individuals are U.S. accounts based solely on a search of electronically searchable account information for certain “U.S. indicia.”\footnote{32 Treas. Reg. § 1.1471-4(c)(5)(iv)(C).}

For this purpose, “U.S. indicia” include any of the following:

- Designation of the account holder as a U.S. citizen or resident;
- A U.S. place of birth;
- A current U.S. residence or mailing address (including a U.S. post office box);
- A current U.S. telephone number;
- Standing instructions to pay amounts from the account to an account in the U.S.;
- A current power of attorney or signatory authority granted to a person with a U.S. address; or
- An “in-care-of” address or “hold mail” address that is the sole address the FFI has identified for the account holder.\footnote{33 Treas. Reg. § 1.1471-4(c)(5)(iv)(B).}

With respect to the timetable for compliance, the Final Regulations treat all accounts maintained by an FFI prior to January 1, 2014, as preexisting accounts.\footnote{34 Treas. Reg. § 1.1471-1(b)(95), (b)(98)(i).}
DETERMINING WHETHER ACCOUNT HAS A SUBSTANTIAL U.S. OWNER

The Final Regulations include rules for determining whether a specified U.S. person is a substantial U.S. owner.\textsuperscript{35} A foreign corporation is deemed to have a “substantial U.S. owner” if any specified U.S. person owns, directly or indirectly, more than 10 percent of the stock of such corporation by vote or value.\textsuperscript{36} A foreign partnership is deemed to have a “substantial U.S. owner” if any specified U.S. person owns, directly or indirectly, more than 10 percent of the profits interests or capital interests in such partnership.\textsuperscript{37} In the case of a foreign trust, a “substantial U.S. owner” means any specified U.S. person treated as an owner of any portion of the trust under Sections 671 through 679 and any specified U.S. person that holds, directly or indirectly, more than 10 percent of the beneficial interests of the trust, which in turn is defined to include the right to receive mandatory or discretionary distributions from the trust.\textsuperscript{38}

The proposed regulations had required that the determination of whether a person is a substantial U.S. owner be made by calculating such person’s direct and indirect interest in the entity through application of attribution rules. In a change, the Final Regulations do not require an entity to look through interests held by a U.S. person that is not a specified U.S. person when determining whether the entity has a substantial U.S. owner. Instead, the Final Regulations have added a provision that requires an entity making a determination as to whether a specified U.S. person is a substantial U.S. owner to aggregate the interests owned by persons related to the specified U.S. person, applying certain provisions of the regulations under Section 267 to determine whether such persons are related.\textsuperscript{39}

ANNUAL REPORTING OBLIGATIONS

The Final Regulations require each participating FFI to annually report to the IRS information about accounts maintained by specified U.S. persons. The information that is required to be reported to the IRS includes the name, address, and tax identification number of each account holder that is a specified U.S. person; the account number; the account balance or value of the account; the payments made with respect to the account (interest, dividends, and gross proceeds); and such other information as may be required.\textsuperscript{40} For accounts held by U.S.-owned foreign entities, a participating FFI is required to report the following information annually to the IRS: the name of the U.S. owned foreign entity that is the account holder; the name, address, and tax identification number of each substantial U.S. owner of such entity; the account number; the account balance or value of the account; and the payments made with respect to the account during the calendar year (interest, dividends, and gross proceeds).\textsuperscript{41}

The information required to be provided to the IRS by a participating FFI is to be reported on a new Form 8966, entitled “FATCA Report.”\textsuperscript{42} This form must be electronically filed with the IRS on or before March 15 of the year following the calendar year being reported.\textsuperscript{43} A participating FFI may obtain an automatic 90-day extension of the deadline by filing a Form 8809, “Request for Extension of Time to File Information Returns,” and may obtain an additional 90-day extension by demonstrating certain “hardship conditions.”\textsuperscript{44}

The Final Regulations modify the due date for the first information report by requiring participating FFIs to file their first FATCA Reports with respect to the 2013 and 2014 calendar years not later than March 31, 2015.\textsuperscript{45}

ALTERNATIVE INTERGOVERNMENTAL AGREEMENT APPROACH

Recognizing that in some instances, foreign laws may prevent an FFI from complying with its reporting obligations under FATCA, Treasury is working with foreign governments to develop an alternative approach to FATCA implementation through the use of intergovernmental agreements (IGAs). To date, Treasury has published two alternative model IGAs that it says “facilitate the effective and efficient implementation of FATCA in a manner that removes domestic legal impediments to compliance, fulfills FATCA’s policy objectives, and further reduces burdens on FFIs located in partner jurisdictions.”\textsuperscript{46}

\textsuperscript{35} Treas. Reg. §§ 1.1471-1(b)(119), 1.1473-1(b).
\textsuperscript{36} Treas. Reg. § 1.1473-1(b)(1)(i).
\textsuperscript{37} Treas. Reg. § 1.1473-1(b)(1)(ii).
\textsuperscript{38} Treas. Reg. §§ 1.1473-1(b)(1)(iii), 1.1473-1(b)(3).
\textsuperscript{39} Treas. Reg. § 1.1473-1(b)(2)(v).
\textsuperscript{40} Treas. Reg. § 1.1471-4(d)(3)(ii).
\textsuperscript{41} Treas. Reg. § 1.1471-4(d)(3)(iii).
\textsuperscript{42} Treas. Reg. § 1.1471-4(d)(3)(vi).
\textsuperscript{43} Treas. Reg. § 1.1471-4(d)(3)(viii).
\textsuperscript{44} Treas. Reg. § 1.1471-4(d)(3)(vii).
\textsuperscript{45} Treas. Reg. § 1.1471-4(d)(7)(iv)(B).
Model 1 IGA. The first model intergovernmental agreement was published on July 26, 2012. A partner jurisdiction signing a Model 1 IGA with the United States agrees to adopt rules to identify and report information about U.S. accounts that meet the standards set out in the Model 1 IGA. FFIs covered by a Model 1 IGA must identify U.S. accounts pursuant to due diligence rules adopted by the partner jurisdiction and report specified information about the U.S. accounts to the partner jurisdiction. The partner jurisdiction then exchanges this information with the IRS on an automatic basis.

FFIs covered by a Model 1 IGA, and that are in compliance with local laws implemented to identify and report U.S. accounts in accordance with the terms of the Model 1 IGA, will be treated as satisfying the due diligence and reporting requirements of FATCA. Accordingly, these FFIs do not need to apply the Final Regulations for purposes of complying with and avoiding withholding under FATCA.

Model 2 IGA. A second model intergovernmental agreement was published on November 14, 2012. A partner jurisdiction signing a Model 2 IGA with the United States agrees to direct all FFIs that are located in the jurisdiction to register with the IRS and report specified information about U.S. accounts directly to the IRS in a manner consistent with Chapter 4 and the Final Regulations, except as expressly modified by the Model 2 IGA. In the case of certain recalcitrant account holders, the information reported to the IRS by FFIs covered by a Model 2 IGA is supplemented by a government-to-government exchange of information.

Current Status of Treasury’s Efforts to Negotiate IGAs. In September 2012, the U.S. and the United Kingdom announced that they had signed the first IGA implementing FATCA. Two months later, Treasury announced that it was engaging with more than 50 countries and jurisdictions in order to implement FATCA and improve international tax compliance. Specifically, Treasury stated that it was currently negotiating IGAs with France, Germany, Italy, Spain, Japan, Switzerland, Canada, Denmark, Finland, Guernsey, Ireland, the Isle of Man, Jersey, Mexico, the Netherlands, and Norway. To date, United Kingdom, Mexico, Denmark, Ireland, Switzerland, Spain, and Norway, Germany, and Japan have signed or initialed model agreements.

The U.S. is also engaged in a dialogue aimed at concluding intergovernmental agreements with the following countries: Argentina, Australia, Belgium, the Cayman Islands, Cyprus, Estonia, Hungary, Israel, Korea, Liechtenstein, Malaysia, Malta, New Zealand, the Slovak Republic, Singapore, and Sweden. Finally, Treasury has announced that it is exploring options for intergovernmental engagement with Bermuda, Brazil, the British Virgin Islands, Chile, the Czech Republic, Gibraltar, India, Lebanon, Luxembourg, Romania, Russia, Seychelles, Saint Maarten, Slovenia, and South Africa.

DUTIES OF FATCA RESPONSIBLE OFFICER

Initial Certifications. The Final Regulations require participating FFIs to designate a responsible officer to make certain certifications to the IRS. The responsible officer may be any officer of any participating FFI.


54 Treas. Reg. § 1.1471-1(b)(108) (definition of “responsible officer”).
or reporting Model 1 FFI in the participating FFI’s expanded affiliated group who has sufficient authority to fulfill the duties of a responsible officer as described in the regulations.\textsuperscript{55}

First, the responsible officer must certify, to the best of his or her knowledge after conducting a reasonable inquiry, that the participating FFI does not have any formal or informal practices or procedures in place since August 6, 2011, to assist account holders in avoiding FATCA requirements.\textsuperscript{56} Specific examples of such practices or procedures include advising that account holders of U.S. accounts close, transfer, or withdraw from their account to avoid reporting; intentional failures to disclose a known U.S. account; or advising that an account holder remove U.S. indicia from its account information.\textsuperscript{57} An e-mail requiring responses from relevant customer on-boarding and management personnel as to whether they engaged in, or have knowledge of, any such practices is considered a reasonable inquiry for purposes of responsible officer certifications.

A n e-mail requiring responses from relevant customer on-boarding and management personnel as to whether they engaged in, or have knowledge of, any prohibited practices is considered a reasonable inquiry for purposes of responsible officer certifications.

The periodic ongoing certification and correction of material failures. The Final Regulations require the responsible officer, on behalf of the participating FFI, to periodically certify to the IRS that the FFI is in compliance with the requirements of the FFI agreement. Such certification is required once every three years.\textsuperscript{60} In advance of such certification, a participating FFI is required to review its compliance program and its compliance with the requirements of the FFI agreement. The responsible officer is required to certify to the IRS that the FFI maintains effective internal controls and that there were no material failures during the certification period, or that any material failures that did occur were corrected.\textsuperscript{61}

A “material failure” is defined as a failure of the participating FFI to fulfill the requirements of the FFI agreement if the failure was the result of a deliberate action by the participating FFI to avoid the requirements of the FFI agreement or was an error attributable to a failure to implement sufficient internal controls.\textsuperscript{62} A material failure that occurs in limited circumstances will not result in an event of default. If a material failure occurring during the certification period has not been corrected, or if an event of default has occurred, the Final Regulations provide that a responsible officer may instead make a qualified certification.\textsuperscript{63}

The IRS may contact the participating FFI to request additional information regarding the information reported on its returns, and for inquiries when the IRS determines in its discretion that there may have been substantial non-compliance with an FFI agreement.\textsuperscript{64} The IRS has said that it expects that inquiries regarding substantial noncompliance will not be made on a routine basis.\textsuperscript{65} If the IRS concludes that an FFI has been substantially noncompliant, the IRS may inquire as to the FFI’s compliance with certain requirements of the FFI agreement and may request information necessary to verify the participating FFI’s compliance with the FFI agreement, such as a description of the

\begin{itemize}
  \item \textsuperscript{55} Id.
  \item \textsuperscript{56} Treas. Reg. § 1.1471-4(c)(7).
  \item \textsuperscript{57} Id.
  \item \textsuperscript{58} Id.
  \item \textsuperscript{59} Treas. Reg. § 1.1471-4(f)(1), (f)(2)(i).
  \item \textsuperscript{60} Treas. Reg. § 1.1471-4(f)(3)(i).
  \item \textsuperscript{61} Treas. Reg. § 1.1471-4(f)(3)(ii).
  \item \textsuperscript{62} Treas. Reg. § 1.1471-4(f)(3)(iv).
  \item \textsuperscript{63} Treas. Reg. § 1.1471-4(f)(3)(iii).
  \item \textsuperscript{64} Treas. Reg. § 1.1471-4(f)(4)(i) and (ii).
  \item \textsuperscript{65} Final Regulations, Preamble, Summary of Comments and Explanation of Revisions Part V.F.4.
\end{itemize}
participating FFI’s procedures for conducting its periodic review. The IRS may also request the performance of specified review procedures (including an external audit). If the IRS determines, based upon its review, that the FFI has not substantially complied with the requirements of an FFI agreement, it will deliver a notice of event of default.

The Final Regulations define an event of default of the FFI agreement and describe procedures for a participating FFI to remediate an event of default and clarify that an event of default does not result in automatic termination of the FFI agreement. If the IRS becomes aware of an event of default, it will deliver a notice of default to the participating FFI and allow the participating FFI to develop a plan to remediate the event of default. If the participating FFI fails to respond to the notice of default or comply with an agreed-upon remediation plan, the IRS may terminate the FFI’s participating FFI status within a reasonable period of time, subject to a written request for reconsideration of termination to the LB&I, Assistant Deputy Commissioner (International).

WITHHOLDING OBLIGATIONS UNDER FATCA

A withholding agent in the United States is required to withhold payments of U.S.-sourced FDAP income—including interest, dividends, and similar payments—to non-FATCA-compliant individuals and entities. The withholding agent is required to show on Form 1042 (“Annual Withholding Tax Return for U.S. Source Income of Foreign Persons”) the aggregate amount paid and tax withheld that must be reported on Form 1042-S (“Foreign Person’s U.S. Source Income Subject to Withholding”). Form 1042-S is filed with the IRS before March 15 of the year following the year in which the reporting was made.

FATCA now imposes additional withholding tax obligations to enforce the reporting requirements on foreign accounts owned by U.S. persons or U.S.-owned foreign entities. Withholding is required on payments and also on gross proceeds from sales of U.S. securities to foreign entities that do not comply with FATCA requirements.

Planning reminder: A participating FFI must file Form 1042-S for foreign reportable payment amounts to non-participating FFI’s beginning in 2015. This is true even though the effective date for withholding on payments made to another FFI (which is considered a passthru payment) has been delayed until January 1, 2017. Form 1042-S reflects the new requirements for FATCA and will be effective for the 2014 reporting year.

The Final Regulations require a participating FFI to withhold 30 percent of any passthru payment to a recalcitrant account holder or to a nonparticipating FFI. A passthru payment is defined in Section 1471(d) (7) as any withholdable payment or other payment to the extent attributable to a withholdable payment. We previously discussed the definition of a recalcitrant account holder. A participating FFI may, subject to such requirements as the Secretary may provide, elect under Section 1471(b)(3) not to withhold on passthru payments, and instead be subject to withholding on payments it receives, to the extent those payments are allocable to recalcitrant account holders or nonparticipating FFIs. Section 1471(b)(1)(D)(ii) requires a participating FFI that does not make such an election to withhold on passthru payments it makes to any participating FFI that makes such an election.

There has been controversy with respect to the treatment of passthru payments and the effective date for withholding has been postponed until January 1, 2017, or six months after the date of publication in the Federal Register of final regulations defining the term foreign “passthru payments.”

NEW FATCA REPORTING FORMS

A number of new and revised IRS forms must be issued due to the new certification, reporting, and withholding requirements of Chapter 4. For purposes of obtaining certifications of account holder status for Chapter 3 purposes, withholding agents have historically relied on IRS forms in the Form W-8 series. These forms are in the process of being modified for Chapter 4 purposes. It should be noted, however, that the Final Regulations provide that a financial institution, depending on the circumstances, may also rely

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67 Treas. Reg. § 1.1471-4(g).
68 Treas. Reg. § 1.1471-4(g)(2).
69 Treas. Reg. § 1.1474-1(i)(2).
70 See text supra at note 13.
72 Treas. Reg. § 1.1471-4(b)(4).
on substitute forms, written certifications, and other documentation.\textsuperscript{73}

The IRS has already released draft versions of the following revised forms:

- Form W-8IMY, “Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding”;
- Form 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
- Form W-8EXP, “Certificate of Foreign Government or Other Foreign Organization for United States Tax Withholding.”

The IRS intends to release a new Form W-8BEN-E, “Certificate of Status for Beneficial Owner for United States Tax Withholding (Entities),” to be used only by beneficial owners that are entities and, shortly thereafter, a draft version of a revised Form W-8BEN, “Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding,” to be used only by beneficial owners that are individuals.

As noted above, the IRS also intends to release a new Form 8966, “FATCA Report,” that will be used by FFIs and withholding agents to comply with their Chapter 4 reporting obligations. This new Form 8966 will set forth all the information that must be reported with respect to financial accounts in accordance with these regulations. Finally, the IRS intends to issue a revised Form 1042, “Annual Withholding Tax Return for U.S. Source Income of Foreign Persons,” and Form 1042-S, “Foreign Person’s U.S. Source Income Subject to Withholding.” Revised Forms 1042 and 1042-S will set forth all the information that must be reported by withholding agents to meet their obligations under both Chapter 4 and Chapter 3.

\textbf{CONCLUSION}\hfill

The arrival of FATCA heralds a new era with respect to offshore investing by U.S. taxpayers and arms the U.S. government with a powerful new tool to detect and root out offshore tax evasion. Although the Final Regulations ease some of the administrative burdens contained in the proposed regulations, there are still daunting compliance challenges in ensuring compliance with FATCA’s due diligence, verification, and reporting obligations. FFIs and withholding agents are well advised to begin immediate preparations in order to meet FATCA’s rapidly approaching implementation deadlines. At the same time, U.S. taxpayers maintaining offshore accounts will soon face a new paradigm where bank secrecy jurisdictions no longer offer the protection and anonymity they once touted.\textsuperscript{74} In light of FATCA’s mandate that foreign banks annually disclose the names of their U.S. depositors or face costly financial penalties in the form of withholding on U.S. source payments, non-compliant account holders can no longer assume that they will remain undetected or protected by foreign banking secrecy laws.

\textsuperscript{73} Treas. Reg. § 1.1471-3(c)(6).
