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First Guidance Regarding Implementation of the FATCA Information Reporting and Witholding Regime

I. Introduction

On August 27, 2010 the Internal Revenue Service (the "IRS") published Notice 2010-60 (the "Notice"), providing initial guidance on certain priority issues regarding the Foreign Account Tax Compliance ("FATCA") provisions of the Hiring Incentives to Restore Employment Act (the "HIRE Act"), which was enacted on March 18, 2010. The Notice is significant since it is the first step in the process of implementing the complicated and expansive reporting and withholding regime introduced by the FATCA provisions.

The Notice is intended only as preliminary guidance with respect to certain issues raised by the FATCA provisions and leaves open many critical questions presented by the statute. With respect to some of these open questions, the Notice specifically requests comments or indicates that guidance will be provided in forthcoming proposed regulations. With respect to other important issues, the Notice is completely silent.[1] The private sector has provided extensive comments to the IRS with respect to a number of these issues, and we expect that most of them will be addressed in a subsequent round of guidance.

Some of the principal issues addressed by the Notice include the following:

- The Notice contemplates limiting the categories of foreign financial institutions ("FFIs") that will be subject to extensive withholding and reporting requirements under FATCA, by creating exceptions for certain retirement plans, property and casualty insurance companies, holding companies, finance subsidiaries, start-up companies, companies in the process of reorganization or liquidation, and foreign-targeted funds, and providing a simplified regime for certain other categories of foreign entities.
- The Notice indicates that the IRS is considering adopting rules that minimize potential duplicative reporting in situations in which an "account" maintained

[1] Several of these issues are briefly discussed in Part VII, below. Many of these issues are also discussed in our memorandum "*Proposed Legislation Focused on Offshore Tax Evasion*" dated October 31, 2009, which described a proposed version of the FATCA legislation.

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by an FFI (such as bonds or shares issued by a securitization vehicle or investment fund) is held in custody, including in street name, through another FFI (such as a broker or clearinghouse). (Ordinarily, both the instruments issued by the first FFI and the custodial account would be considered financial accounts with respect to which the FFIs are required to report.) In such a case, only the FFI that has the most direct relationship with the U.S. accountholder would be required to report with respect to the accountholder.

- The Notice provides substantial guidance regarding the scope of the due diligence and documentation requirements with which FFIs and U.S. financial institutions ("USFIs") will need to comply to determine the characteristics of their accountholders. These requirements are likely to raise operational, implementation and cost issues for FFIs and USFIs.

- The Notice indicates that foreign entities that are engaged in the conduct of an active trade or business (other than a financial business) generally will be exempt from the new FATCA withholding and reporting regime.

In a number of respects, the Notice reflects an effort by the IRS to be responsive to concerns raised by commentators that the new rules be implemented in a manner that is not unduly burdensome. However, implementation of many of the procedures described in the Notice – in particular those applicable to the account identification and documentation procedures – may prove to be challenging in practice for financial institutions, in particular those having a large customer base with millions or tens of millions of accounts.

The Treasury Department and the IRS will face challenges in further refining the guidance provided by the Notice and issuing additional guidance necessary for financial institutions and other persons affected by FATCA to start developing information collection and reporting systems in a manner that is administrable for such persons, and doing so in a time frame that allows market participants sufficient time to implement the required systems.[2]

The remainder of this memorandum provides a brief background discussion of the FATCA provisions, summarizes the Notice's principal provisions and provides preliminary observations regarding its implications, and identifies certain critical issues that are not addressed in the Notice.

[2] In general, we believe that at this stage the Notice does not provide sufficiently detailed or comprehensive guidance to require revisions to the standard documentation that is used in cross-border lending, capital markets and other transactions, other than the revisions that have been implemented as a result of the adoption of the FATCA statutory provisions earlier this year.

II. Background

The principal goal of the FATCA provisions was to prevent tax evasion by U.S. taxpayers. The rules adopted to implement this narrow objective, however, have a broad reach. The FATCA provisions introduce a complex and expansive reporting and withholding regime that is intended to force non-U.S. financial intermediaries and U.S.-owned foreign entities to identify and report on U.S. accountholders and investors. This new regime will operate as a parallel system to the existing withholding tax system, including the qualified intermediary ("QI") program.

Under the FATCA rules, withholding agents will be required to withhold a 30% U.S. tax with respect to any "withholdable payment" made to a foreign entity after December 31, 2012, unless the foreign entity complies with the FATCA reporting requirements or qualifies for an exemption from these provisions. Withholdable payments include (i) U.S. source dividends, interest or other "fixed or determinable annual or periodical gains, profits, and income" (also known as "FDAP" income); and (ii) any gross proceeds from the sale of assets that can produce U.S. source dividends or interest. Although these rules are effective for payments made after December 31, 2012, they generally do not apply to "obligations" that are outstanding on March 18, 2012.[3]

The FATCA rules impose separate reporting requirements for FFIs and other foreign entities. An FFI generally will be subject to the 30% U.S. withholding tax unless it enters into an agreement with the IRS pursuant to which it will be required to identify and report to the IRS information with respect to certain U.S. persons that directly or indirectly hold depository and custodial accounts at the FFI and equity and debt of the FFI (other than interests that are regularly traded on an established securities market). FFIs include foreign banks, broker-dealers and entities conducting custodial businesses, as well as any foreign entity engaged primarily in the business of investing or trading securities, partnership interests, commodities or any derivative interests therein (*e.g.*, non-U.S. mutual fund-like vehicles such as UCITS and SICAVs, hedge funds, private equity funds, securitization vehicles and virtually any other private or widely held investment entity).[4]

A foreign entity that is not an FFI (which FATCA refers to as a "non-financial foreign entity," or "NFFE"), and that is not otherwise exempt,[5] will be able to avoid the

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[3] Certain issues relating to this grandfather rule are discussed in Part III, below.

[4] The Notice indicates that the concept of engaging in a "business" of investing or trading securities or other interests may be defined more broadly than the activities that would give rise to a "trade or business" for other U.S. tax purposes. The Notice indicates that this definitional issue will be addressed in future guidance.

[5] FATCA provides that the following NFFEs generally are exempt from FATCA withholding: (i) corporations the stock of which is regularly traded on an established securities market and their

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30% U.S. withholding tax on withholdable payments only if (i) it provides the name, address and taxpayer identification number of each of its substantial United States owners;[6] (ii) the withholding agent does not know or have any reason to know that the information is incorrect; and (iii) the withholding agent reports that information to the IRS.

III. Grandfather Rule

FATCA contains a statutory grandfather rule for "obligations" outstanding on March 18, 2012, but does not define this term. The Notice helpfully clarifies that the term "obligation" means any legal agreement that produces or could produce withholdable payments, other than equity interests (including both stock and partnership interests) or agreements that lack a definitive expiration or term. (Thus, savings deposits, demand deposits, and other similar accounts will *not* be eligible for the grandfather rule.) The Notice also provides that brokerage, custodial and similar agreements to hold financial assets for the account of others are not eligible for the grandfather rule.

The Notice provides that an instrument will lose the grandfather protection if it undergoes a material modification after March 18, 2012.[7] Because this treatment apparently applies even if the modification does not involve any new extension of credit, it may complicate debt workouts effected after that date.

Contrary to the hopes of many commentators, the Notice is silent with respect to any grandfather relief in other cases, such as debt issued pursuant to a binding commitment entered into before March 19, 2012 or debt issued under a revolving credit agreement or similar arrangement entered into before March 19, 2012.

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affiliates, (ii) entities that are organized under the laws of a possession of the United States and that are wholly owned by one or more residents of such possession, (iii) foreign governments, (iv) international organizations and (v) foreign central banks of issue.

[6] FATCA generally defines "substantial United States owner" as any "specified United States person" that owns, directly or indirectly, more than 10% of the equity of the NFFE. A "specified United States person" generally is any U.S. person other than regularly traded corporations and their affiliates, banks, governmental entities, RICs, REITs and certain tax-exempt organizations and trusts.

[7] In the case of an obligation that constitutes indebtedness for U.S. tax purposes, a material modification is defined as any significant modification within the meaning of the regulations adopted under section 1001 of the Internal Revenue Code (the "Code").

IV. Foreign Financial Institutions

A. Exemptions.

FATCA defines "foreign financial institution" quite broadly, although it provides the IRS with the authority to provide exceptions where appropriate. The Notice implements this authority, although it does so in a fairly restrained manner, adopting a number of narrowly targeted exceptions to the definition of FFI for the types of entities described below. The Notice also requests comments as to how these classes of entities may be more specifically defined in the regulations and whether other classes of entities should be similarly excluded.

As described below, the Notice implements these exceptions in different ways. In some cases, entities are fully exempt from FATCA; in other cases, they are treated as subject to FATCA but exempt from certain obligations or otherwise entitled to special treatment. The differing treatment of different categories of exempt entities may create added complexity for financial institutions that are developing systems to implement the FATCA requirements.

- *Holding companies*. A non-U.S. holding company for an operating subsidiary or group of subsidiaries engaged primarily in a non-financial business will be excluded from the definition of FFI and exempt from the requirements imposed on NFFEs. However, this class of excepted entities will not include any entity that functions as a private equity fund, venture capital fund, leveraged buyout fund, or similar investment vehicle.

- *Start-up companies*. A foreign start-up entity that is investing capital into assets with the intent to operate a business other than that of a financial institution, but that is not yet operating such a business, will be excluded from the definition of FFI and exempt from the requirements imposed on NFFEs for the first 24 months after its organization.

- *Entities in the process of liquidation or reorganization*. A non-U.S. entity that is in the process of liquidating its assets or reorganizing with the intent to recommence a non-financial business will be excluded from the definition of FFI and exempt from the requirements imposed on NFFEs if it was not an FFI before the beginning of such liquidation or reorganization process.

- *Finance subsidiaries*. A non-U.S. entity that primarily engages in financing or hedging transactions for affiliates that are not FFIs and that does not provide such services for non-affiliates will be excluded from the definition of FFI and exempt from the requirements imposed on NFFEs.

- *Insurance companies*. The Notice states that the Treasury Department and the IRS do not view the issuance of insurance (or reinsurance) contracts that have no cash value as implicating the policies implemented by FATCA. Thus, the Notice provides that entities whose business consists *solely* of issuing such contracts will not be treated as FFIs. Accordingly, non-U.S. property and casualty insurance companies generally will be excluded from the obligations imposed on FFIs. However, the Notice expresses concern that most life insurance contracts (other than term insurance with no cash value) and annuity contracts include an investment component and thus may present a risk of tax evasion that FATCA was intended to prevent. Thus, the Notice provides no exemption for insurance companies that issue such contracts, and solicits comments regarding the proper treatment of such entities.

  In addition, it appears that, unlike the treatment of the four previous categories of exempt entities, insurance companies that are treated as non-FFIs will *not* be exempt from the rules applicable to NFFEs. Thus, these entities will be subject to the requirements relating to the disclosure of their substantial United States owners, unless they separately are exempt under those rules (for example, because their stock is regularly traded on an established securities market).

- *Retirement plans.* The Notice indicates that non-U.S. retirement plans pose a low risk of tax evasion and will therefore be exempt from FATCA withholding. However, the Notice's exemption for foreign retirement plans applies only if a plan (i) qualifies as a retirement plan under local law, (ii) is sponsored by a non-U.S. employer, and (iii) does not allow U.S. participants or beneficiaries other than employees who worked in the country where the plan is established. This approach seems overly narrow, since it would exclude many other bona fide retirement plans that pose little risk of tax avoidance, such as plans implemented by multinational corporations or corporate groups with U.S. employees outside the home country and foreign government-sponsored social-security-type programs.

- *Small investment funds with certain identified owners*. Certain non-U.S. investment entities would be treated as FFIs that are deemed to comply with their obligations if they comply with reporting requirements that are substantially similar to the reporting requirements applicable to NFFEs. Under this exemption, the relevant withholding agent would be required to (i) identify all direct or indirect owners of the entity that are individuals, specified United States persons or exempt NFFEs, (ii) obtain documentation from such persons and (iii) report to the IRS information regarding any specified United States person that is a direct or indirect shareholder in the entity. This exemption effectively shifts the principal compliance burdens from the small non-U.S. investment entity to the withholding agent.

The Notice does not provide detailed guidance regarding the scope of the investment funds to which this exemption will apply. However, the Notice suggests that the rule is intended to apply to entities that have only a small number of direct or indirect owners, all of whom are persons that themselves are not subject to the reporting requirements (*e.g.*, a small family trust settled and funded by a single person for the sole benefit of his or her children).

- *Foreign-targeted funds*. The Notice indicates that the IRS is considering providing an exemption for non-U.S. investment vehicles that adopt procedures to prevent U.S. persons from investing (such as pursuant to the U.S. Investment Company Act). However, the IRS seems to be concerned that procedures used to monitor and enforce these restrictions may not be sufficiently robust to ensure that an exemption from FATCA is appropriate. Thus, the IRS has requested comments on a number of issues relating to the possible creation of an exemption for such entities.

- *Charitable organizations*. The Notice does not provide an exception for foreign charitable organizations that may fall within the definition of FFI, but has solicited comments regarding whether such an exception would be appropriate.

B. Considerations for Other FFIs.

Securitization Vehicles. Notably, the Notice does not contain an exception for securitization vehicles (such as CDO issuers), which has been requested by several commentators. However, the special rules contemplated for custodial arrangements, described below, should provide substantial relief for such vehicles.

Custodial Arrangements. The Notice contemplates a potentially very helpful rule that limits the impact of FATCA's due diligence and reporting rules in many cases in which an FFI does not have a direct relationship with the ultimate beneficial owner of an account. Under this rule, if an account of a participating FFI (*i.e.*, an FFI that enters into an agreement with the IRS) – such as shares of a fund or interests in a securitization vehicle – are held in custody through another participating FFI – such as a broker or clearinghouse – only the custodian FFI will be required to report with respect to the account because it has the most direct relationship with the accountholder. Assuming that the principal clearinghouses and brokers will enter into FFI agreements with the IRS, then the reporting requirements for any CDO issuer or similar vehicle all of whose debt and equity is held through such a clearinghouse or broker would be significantly simplified.[8] This custodian

[8] In the absence of further guidance, it appears that the securitization vehicle would still have to agree to comply with the basic requirements of the FFI program, including the verification requirements. Additionally, the Notice suggests that the entity may have to comply with some reporting requirements with respect to any payments made to other FFIs, even if they are not required to report details regarding the ultimate beneficial owners of the payments.

rule also should provide substantial relief to other FFIs, which generally would not be required to report with respect to investors in their stock and debt securities, unless those instruments are held in physical form.

It is not entirely clear how this custodian rule will apply in the context of U.S. clearinghouses or other U.S. custodians. U.S. entities technically cannot qualify as FFIs, so the rule described above would not apply. The IRS should consider expanding the principle of this special custodian rule to circumstances involving such U.S. entities in future guidance.

U.S. Branches of FFIs and Controlled Foreign Corporations. A number of commentators had requested that U.S. branches of foreign financial institutions and controlled foreign corporations ("CFCs") be excluded from the rules applicable to FFIs, since such entities already are subject to substantial U.S. tax reporting requirements. Nevertheless, the Notice provides that an FFI will not be exempt from the requirement to enter into an agreement with the IRS even if it receives all of its withholdable payments solely through its U.S. branch. Furthermore, the Notice provides that the IRS will not exempt CFCs from the FFI regime because their current information reporting requirements are less stringent than those that FATCA imposes on FFIs. The Notice provides in both cases, however, that there will be coordination with the U.S. branches' and the CFCs' current reporting obligations to avoid duplicative reporting.

C. FFI Agreements.

The Notice indicates that a draft FFI agreement is forthcoming, but, other than the due diligence and documentation provisions discussed in Part V, below, does not provide detailed guidance with respect to the requirements that will be imposed regarding these agreements.

With respect to reportable accounts, the FATCA statutory provisions generally require that an FFI report, *inter alia*, (i) the "account balance or value", determined in such manner as the IRS provides; and (ii) the gross receipts and gross withdrawals or payments from the account, except to the extent provided by the IRS. With respect to the "account balance or value" requirement, the Notice indicates that the IRS is considering requiring the reporting of the highest month-end balance during the year (or, in some cases, the highest value determined for purposes of reporting to the accountholder). Although the Notice appears to reflect a sensitivity to the burdens that this reporting will place on FFIs, it will be important for the IRS to ensure that the details of the reporting requirements are workable for financial institutions.

The IRS has received a number of comments suggesting that the requirement to report the gross receipts and withdrawals or payments relating to reportable accounts will be highly burdensome for financial institutions. The Notice provides no guidance with

respect to this requirement, but requests comments as to how it might be implemented in a way that minimizes burdens on participating FFIs.

V. Due Diligence and Documentation Requirements

A substantial portion of the Notice is devoted to providing an overview of a detailed set of procedures that withholding agents and FFIs will need to use to identify the U.S. or non-U.S. status of accountholders and the characteristics of those accountholders (*e.g.*, whether they are FFIs or NFFEs). This memorandum provides only a high-level summary and comments with respect to the basic framework underlying the technical processes and procedures that an FFI or USFI will be required to follow to determine the factors relevant to establishing the status of an account.

Very generally, accounts held by individuals are subject to different rules than accounts held by entities. Consistent with the statutory provisions, the Notice excludes depository accounts held by an individual from the information reporting requirements if the average balance in the calendar year preceding the effective date of the FFI agreement is less than $50,000.[9] The Notice also indicates, however, that accounts that are excluded under this rule may be required to be re-examined in subsequent years if their average balance exceeds $50,000 in such subsequent years.

The Notice attempts to reduce the burdens on FFIs and USFIs that are acting as withholding agents by providing different rules for "existing" and "new" accounts. The Notice prescribes more rigorous due diligence requirements for new accounts, which it defines as accounts that are opened after an FFI's agreement with the IRS enters into force or, in the case of a USFI, accounts that are opened on or after January 1, 2013.

Existing Accounts Maintained by FFIs. For existing accounts, the Notice generally provides that an FFI is not required to obtain new documentation regarding an account except where the electronically searchable information already on hand indicates that the accountholder may be a U.S. person. However, if such an electronic search reveals any indicia of U.S. status, then the FFI generally will be required to obtain additional

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9 The average balance is determined based on the month-end balances or values during the calendar year preceding the entry into force of the FFI's FFI agreement (or, in some cases, the average of the balance or value as determined for purposes of reporting to the accountholder during the year). Pursuant to the statutory provisions, accounts held by the same FFI will be aggregated for purposes of determining whether the $50,000 threshold is exceeded. The statutory provisions also authorize the IRS to require that accounts held at financial institutions that are affiliated be aggregated, but the Notice does not indicate that the IRS intends to exercise this authority.

documentation (*e.g.*, a Form W-9 or W-8 and documentary evidence of non-U.S. status) to establish the precise status of the account.[10]

The ability to rely on electronic searches of customer files is critically important for FFIs, many of which may have millions of customer accounts for which the account documentation exists primarily in paper form. A manual search of those files would not be feasible. The benefit of these relatively easier electronic search procedures is, however, substantially limited in several respects:

- First, as described above, if the initial electronic search of files reveals accounts that have indicia of U.S. status, further review will be required, and additional documentation generally must be obtained. For a financial institution with a large customer base, this may prove to be a substantial undertaking, even if only a small percentage of its accounts have indicia of U.S. status.

- Second, accounts held by individuals generally must be documented in the same manner as new accounts within 2 - 5 years of the effective date of the FFI agreement.[11]

- Third, these rules apply only to existing *accounts*. If an existing accountholder opens a new account, the new account would not benefit from these more favorable existing account rules. Further clarification as to what constitutes the opening of a new "account" with respect to existing accountholders may be needed in this regard.

In circumstances in which the documentation that an FFI has or receives indicates that an accountholder is an NFFE, the Notice states that the FFI must (i) specifically identify *each individual, and each other specified United States person* that has a direct or indirect interest in the NFFE and (ii) if a specified United States person is so identified, treat the account as a U.S. account that is subject to reporting.[12] This requirement appears

[10] On the other hand, if such an electronic search does not reveal any indicia of U.S. status, then the rules generally permit an FFI to presume that the account is held by a non-U.S. accountholder. In the case of accounts held by entities, further review of account records is required. Entities for which the account records "clearly indicate" that the accountholder is an FFI are presumed to be such and are treated as non-participating FFIs if confirmation of their participating FFI status is not received.

[11] Existing accounts held by individuals that have an average balance exceeding $1,000,000 during the year preceding the first year in which the FFI agreement enters into effect generally will be subject to the rules applicable to new accounts within 2 years after the effective date of the FFI agreement. Other accounts generally must be so documented within 5 years after the effective date of the FFI agreement.

[12] A comparable rule applies to accounts held by USFIs.

to be substantially broader than the FATCA statutory provision, which generally requires such reporting only with respect to 10% direct or indirect U.S. shareholders of an NFFE. We believe that this result was unintentional, and anticipate that the scope of this requirement will be clarified in future guidance.[13]

New Accounts Maintained by FFIs. To establish the U.S. or non-U.S. status of new accounts, the Notice generally requires that an FFI obtain "documentary evidence" and that it examine all other information collected in connection with the new account (regardless of whether such information is electronically searchable). The Notice does not specifically define the scope of the term "documentary evidence." The Notice's use of this general term, however, suggests that such information may in many cases be consistent with information already collected under many FFIs' existing procedures (*e.g*., to comply with local anti-money laundering and know-your-customer requirements). The IRS should provide additional guidance clarifying this issue in the future.

Accounts Maintained by USFIs. To determine its withholding obligations under the FATCA provisions, a USFI will be required to categorize payees into one of seven types of persons.[14] The procedures that the Notice requires that USFIs follow to make this determination are separate from, but substantially similar to, the procedures a participating FFI must follow to establish the status of its accountholders. Because the rules for USFIs are distinct from those applicable to FFIs, in implementing these procedures, the IRS should be particularly mindful to ensure that this parallel USFI system results in a level playing field between FFIs and USFIs.

Payments by Non-USFI Withholding Agents. The Notice provides little guidance to withholding agents that are not financial institutions, such as U.S. non-financial companies making payments for goods and services in the ordinary course of their businesses. However, the Notice helpfully provides that such a withholding agent will be permitted to rely on a certification from a foreign payee (regarding its classification as one of the seven types of persons described in the preceding paragraph) to determine its withholding

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[13] These provisions of the Notice include an additional drafting ambiguity that should be clarified in future guidance. As noted in the text, the Notice requires reporting with respect to "each individual, and each other specified [United States] person" that has an interest in the NFFE. As the Notice is drafted, it is not clear whether the IRS intends to require reporting with respect to any individual, U.S. or foreign, that has an interest in the NFFE, or whether the reference to "individual" is intended to be limited to U.S. persons.

[14] These categories are (i) U.S. persons, (ii) participating FFIs, (iii) deemed-compliant FFIs, (iv) non-participating FFIs, (v) entities that are statutorily exempt from FATCA reporting, (vi) excepted NFFEs and (vii) other NFFEs.

obligations, unless the withholding agent has reason to know that such certification is unreliable or incorrect.[15]

VI. NFFEs Engaged in an Active Trade or Business

The Notice appears to contemplate that NFFEs that are engaged in an active trade or business generally will be exempt from FATCA.[16] The Notice indicates that an FFI will not have to report or withhold, and an USFI will not have to withhold, with respect to an account held by an NFFE if its account records indicate that the NFFE is engaged in an active trade or business. Appropriate evidence in this regard may include statements of business activities, physical assets used in the business, persons employed in business activities, and financial statements or other business records. The Notice also indicates that the IRS is considering allowing FFIs and USFIs to rely in part on information derived from third-party credit databases.

A number of commentators requested an exemption of this nature because these entities generally pose a low risk of U.S. tax evasion. If implemented carefully, this exemption will reduce in many cases the administrative burdens on FFIs, USFIs and other withholding agents under FATCA. Thus, this exemption may be viewed as a welcome attempt by the IRS to balance its interest in ensuring compliance with the U.S. tax laws with administrability and cost considerations.

VII. Issues Not Addressed

Because the Notice is intended only as preliminary guidance with respect to some priority issues, the Notice does not address many significant issues raised by the FATCA provisions. Certain of these issues are highlighted below. The Notice specifically requests comments on some of these issues; with respect to other issues it merely suggests that guidance is forthcoming or it is completely silent.

- *Definition of "financial account" and "withholdable payment" – short-term debt*. The Notice does not indicate whether any exceptions to the statutory definition of "financial account" and "withholdable payment" will be adopted. For example, the Notice does not indicate that the very large market for commercial paper and other short-term debt instruments (which generally are exempt from withholding tax and information reporting) will be excluded from

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15 The Notice also indicates that a similar rule may be adopted for payments made by FFIs or USFIs in cases in which they are not acting as financial payors or intermediaries.

16 This exception is implemented through the documentation requirements imposed on FFIs, USFIs and other withholding agents. The Notice does not, however, discuss the adoption of an exemption as a substantive matter.

the definition of "withholdable payment." It is not clear whether the Notice's silence on this issue indicates that the IRS has not yet decided whether to adopt such exemption, has decided not to include such an exemption or intends to provide an exemption in future guidance.

- *Exempt beneficial owners*. The Notice does not provide guidance regarding the details of the exemptions provided for certain classes of beneficial owners (*e.g.*, foreign governments or regularly traded corporations and their wholly owned subsidiaries), including addressing definitional issues that are critical to determining the breadth of these exemptions. The Notice also does not provide guidance regarding the manner in which such persons may establish their eligibility for exemption.

- *Accountholder documentation*. More generally, the Notice leaves open many questions regarding the circumstances in which simple self-certification (*e.g.*, by providing a Form W-8) will be permitted. The Notice also does not suggest what types of revisions the IRS intends to make to the forms in the existing W-8 series, or whether a new additional form will be developed.

- *Verification processes*. The Notice does not provide significant guidance regarding the procedures that FFIs will be required to use to verify their compliance with their FFI agreements. The Notice suggests that the IRS is considering the use of external auditors to verify compliance with FFI agreements and requests comments regarding the procedures performed by public accountants or other external auditors when conducting audits of anti-money laundering or know-your-customer requirements or similar engagements. The Notice also indicates that the IRS is considering the possibility of relying in some circumstances on written certifications by high-level management regarding the steps taken to comply with an FFI agreement.

- *Treatment of passthru payments*. Under the statutory provisions, a participating FFI must withhold a 30% U.S. tax on any "passthru payment" that is made to (i) a "recalcitrant accountholder"[17] or a non-participating FFI or (ii) a participating FFI that has elected to be withheld upon rather than to withhold with respect to the portion of the payment that is allocable to a recalcitrant accountholder or a non-participating FFI. The Code defines "passthru payment" as any withholdable payment or any other payment to the extent "attributable to" a withholdable payment, but provides no guidance regarding when a payment

[17] A "recalcitrant accountholder" is an accountholder that fails to (i) comply with reasonable requests for the information an FFI needs to determine whether any accounts it holds are reportable accounts and to report with respect to such accounts or (ii) provide a waiver of any law preventing reporting with respect its accounts.

may be “attributable to” a withholdable payment. The Notice similarly provides no guidance on this issue, but acknowledges that difficulties may arise for FFIs in trying to determine whether a payment is “attributable” to a withholdable payment and the burdens that such a process may impose, and requests comments on this issue.

- *Long-term recalcitrant accountholders*. The Notice expresses the IRS’ concern that withholding with respect to passthru payments could become a permanent substitute for collection and reporting of information with respect to U.S. accounts. To address this concern, the IRS is considering what measures it should take to force long-term recalcitrant accountholders into compliance, including terminating FFI agreements due to the number of recalcitrant accountholders remaining after a reasonable period of time. The Notice specifically requests comments on this issue. We note that in designing rules to make FFIs responsible for accountholders’ failure to provide the requested information, consideration will need to be given to the restrictions that foreign laws may impose on FFIs’ ability to force recalcitrant accountholders into compliance (*e.g*., foreign laws that require FFIs to offer certain types of accounts to the public and may restrict their ability to close them).

- *Refunds.* Under the existing withholding tax rules, non-U.S. persons have experienced considerable difficulty in obtaining refunds of overwithheld taxes, especially in cases involving income received through accounts held by an intermediary. Similar concerns are likely to arise under FATCA, in particular in the early years as market participants develop their compliance systems. Unfortunately, the Notice does not indicate whether any type of simplified refund process may be created, or otherwise provide any guidance addressing the technical and practical difficulties that non-U.S. investors may experience in obtaining refunds with respect to overwithheld amounts.

- *Overlap issues.* The Notice does not provide any significant guidance with respect to the coordination between many existing withholding and reporting provisions of the Code and the withholding and reporting regime introduced by FATCA, although the Notice does request comments on certain aspects of this issue.

- *TEFRA*. The HIRE Act generally eliminates U.S. issuers’ ability to issue debt in bearer form, by repealing the long-standing “Eurobond exception” to the “TEFRA” restrictions on the issuance of bearer debt. In connection with this change, the HIRE Act also broadens the definition of “registered form” debt obligations. The Notice does not provide any guidance with respect to a number of technical issues that are raised by these changes.

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Please feel free to contact any of your regular contacts at the firm or any of our U.S. partners and counsel listed under Tax in the "Practices" section of our website (http://www.clearygottlieb.com) if you have any questions.

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