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Publications

New Proposal to Reduce FATCA Administrative Burden

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On December 13, 2018, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") issued a proposed regulation, "Regulations Reducing Burden under FATCA and Chapter 3" (the "Proposed Regulation"). The Proposed Regulation is significant for a number of reasons. First, it eliminates Foreign Account Tax Compliance Act ("FATCA") withholding on gross proceeds. Second, it pauses withholding on pass-through payments. Further, it modifies some of the due diligence requirements for withholding agents, and it clarifies that an entity must have investment discretion in order to qualify as an "investment entity". These changes are intended to reduce the withholding required and the compliance burdens imposed by FATCA.

FATCA Overview

FATCA is a U.S. law enacted in 2010 that is designed to make it more difficult for U.S. citizens to unlawfully avoid taxation on assets in financial accounts that are maintained outside the United States. In addition to requiring reporting by foreign financial institutions, FATCA also requires that certain U.S. taxpayers report information about accounts that they maintain internationally. One of FATCA's tools for ensuring compliance has been that it imposes a 30% withholding tax on certain payments being made from the United States if the receiving financial institution has not agreed to comply with FATCA. Originally, the withholding tax applied to payments of investment income ("fixed, determinable, annual or periodic" payments, referred to as FDAP, and including, for example, dividends, interest, rents, royalties, and insurance premiums) made to non-U.S. financial institutions, and this withholding (known as "Chapter 4" withholding), generally came into effect in 2014. Many of such payments were already subject to withholding at 30% under the existing withholding rules (generally known as "Chapter 3" withholding, and which many tax treaties adjust), and so had some precedent with the withholding agents.

However, under the separate Chapter 4 withholding provisions of FATCA, withholding was scheduled to expand after 2018 to payments of gross proceeds from the sale or other disposition of any property that could produce such FDAP income. This would have been a significant burden on any investors outside the U.S. that could not claim exemptions under FATCA.

30% Gross Proceeds Withholding Eliminated

The Proposal would eliminate the 30% gross proceeds withholding tax described above because Treasury and the IRS concluded that the withholding requirement would impose a large administrative burden on financial institutions and that the burden was no longer justified in light of the progress that had been made in terms of intergovernmental cooperation to reduce tax avoidance.

Pass-Through Withholding Suspended

Another way that withholding could be triggered is if a U.S. accountholder of a FATCA compliant foreign financial institution directed that monies be transferred to a non-FATCA compliant foreign financial institution or to a payee account holder who did not provide tax residence information (a "recalcitrant accountholder"). Here, FATCA imposed withholding to on these "foreign pass-through payments" so that U.S. citizens could not avoid U.S. taxation by moving money offshore via compliant institutions but then investing it via non-compliant institutions or accounts. This, too, was to begin in 2019. Under the proposal, this "pass-through" withholding, unlike the gross proceeds withholding, is suspended, not eliminated. Thus, while not an issue for the time being, it could be reinstated in the future.

Diligence Changes for Withholding Agents

The Proposal also modifies the due diligence requirements that apply to withholding agents. Under FATCA, a withholding agent is a U.S. or foreign person that has control, receipt, custody, disposal, or payment of any item of income of a foreign person that is subject to withholding. Under 2017 guidance, withholding agents were generally required to not only obtain a withholding certificate or other similar document and a treaty statement, but withholding agents were also required to obtain additional information from entities with beneficial owners and re-verify the information every three years. This guidance was being phased in with a transition period set to expire on January 1, 2019. Under the Proposal, withholding agents would not need to re-verify information for certain types of organizations whose status is unlikely to change such as exempt organizations (though not including pension funds), governments, and publicly traded corporations. In addition, the transition period was extended to January 1, 2020.

Investment Entities as Financial Institutions

Many of the obligations under FATCA are triggered if an entity is an "investment entity." One question that has come up is whether a vehicle that invests in mutual funds or other pooled -investment vehicles, but where there is no investment discretion, is itself an "investment entity". The Proposal makes clear that such a vehicle is not an "investment entity" because it would lack "discretionary management" authority.

Reliance on the Proposed Regulations

Generally, the Proposed Regulations can be relied upon until final regulations are issued.

Take Away

For U.S. pension plans that invest internationally and foreign financial institutions that maintain the assets of U.S. customers (such as pension funds), and U.S. withholding agents, FATCA compliance has been an increasing administrative burden. The Proposal represents a step towards reducing that burden, particularly by eliminating gross proceeds withholding and suspending pass-through withholding. Effectively, this means that most of the FATCA regime will remain as is, and will not expand further, at least for now. We will continue to monitor for further relevant developments.

If you have questions about FATCA, please contact David W. Powell at 202-861-6600 or Kevin L. Walsh at 202-861-6645 or your regular Groom attorney.

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