On 30 December 2016, the US Internal Revenue Service (IRS) and Treasury released several information reporting and withholding regulation packages: final and temporary regulations providing further guidance under the Foreign Account Tax Compliance Act (FATCA) (TD 9809); final and temporary regulations under chapters 3 and 61 (TD 9808) of the Internal Revenue Code (Code) that finalize previously issued proposed regulations with some modifications; proposed regulations under chapter 3 (REG-134247-16); and, proposed regulations under FATCA (REG-103477-14) that specifically address certifications and verification requirements imposed on foreign financial institutions and their sponsors.

This Alert covers the 2016 FATCA regulations and the final and temporary regulations under chapters 3 and 61. An EY Global Tax Alert, US IRS issues proposed regulations with verification and certification rules for sponsoring entities, trustees of trustee-documented trusts and compliance FIs, dated 12 January, addresses the certifications and verification requirements imposed on foreign financial institutions and their sponsors.

Background

FATCA is found in chapter 4 of the Code (Sections 1471-1474). Generally, FATCA requires US and non-US withholding agents (including foreign financial institutions (FFIs)) to identify who their payees are and the FATCA status of those payees. For FATCA purposes, US withholding agents must withhold tax
on certain payments to FFIs that do not agree to report certain information to the US regarding their US accounts (non-participating FFIs or NPFFI) and on certain payments to certain non-financial foreign entities (NFFEs) that do not provide information regarding their substantial US owners to withholding agents. The US has entered into numerous Intergovernmental Agreements (IGAs) to minimize the impact of FATCA on a foreign partner jurisdiction’s financial institutions (FIs).

Chapter 3 of the Code (Sections 1441-1446) generally requires withholding at a rate of 30% on US-source fixed or determinable, annual or periodic income paid to nonresident aliens. Chapter 61 of the Code (specifically Sections 6041-6050W) imposes information reporting requirements for payments made to US persons.

To determine a payee’s status under chapters 3, 4 and 61, and any applicable withholding required, withholding agents and payors must generally rely on documentation provided by the payee prior to payment, or, to the extent allowed, on non-tax documentation that the withholding agent already has in its customer files.

The final and temporary chapter 4 regulations are generally effective on 6 January 2017, the date they were published in the Federal Register, but may be applied as of 28 January 2013. The final and temporary chapter 3 and 61 regulations are generally effective on 6 January 2017. The proposed FATCA regulations will be effective when they are finalized.

The 2016 final FATCA regulations (chapter 4)

The chapter 4 regulations generally finalize the prior proposed and temporary regulations, include technical corrections and address comments received by the IRS and Treasury over the past several years.

**Sponsored Entities.** For sponsored entities that have provided the withholding agent with a valid withholding certificate prior to 1 January 2017, a global intermediary identification number (GIIN) is not assumed to be required when the withholding agent can determine from the information provided on a withholding certificate that the sponsored entity is resident, organized or located in a jurisdiction that is treated as having a Model 1 IGA in effect. For sponsored entities that are not from Model 1 countries, withholding agents must obtain and verify the GIIN of the sponsored entity by 31 March 2017. In the event a GIIN is not received and verified, the sponsored entity will be treated as an NPFFI beginning 1 April 2017.

Withholding certificates received from sponsored entities on or after 1 January 2017, must include the sponsored entity’s GIIN, if required.

Withholding agents that classified previously documented sponsored entities that had not furnished GIINs by 1 January 2017 as NPFFIs, must reclassify them in accordance with the new rules. Going forward, an entity that qualifies as a sponsored entity under a Model 1 IGA and is treated as a nonreporting IGA FFI, must check nonreporting IGA FFI as its chapter 4 status to avoid the Forms W-8 being invalidated.

**Documentary evidence.** The final regulations relax the documentary evidence requirements for entities, by removing the requirement that documentary evidence must be “government issued.” This provision can be applied retroactively.

Withholding agents are now in a much better position to cure documentation issues for account holders who were unable to provide government-issued documentation, such as partnerships and trusts, which can now provide formation documents to support their foreign status.

**Curing a hold mail permanent residence address.** The final regulations provide a cure for a permanent residence address that is a hold mail address. The regulations provide that a permanent address subject to a hold-all-mail instruction is a valid address if the account holder provides documentary evidence establishing residence in the country where the account holder is claiming to be a resident.

**Reason-to-know payments to branches.** The final regulations change the reason-to-know rules for withholding agents making payments to an FFI at an address in a jurisdiction other than the jurisdiction for which its GIIN has been provided. Originally, if the withholding agent did not have a GIIN for a branch in the location where it is making a payment, the withholding agent generally had to treat the payment as made to an NPFFI. The final regulations update this rule to provide an exception if the FFI is an investment entity. Also, if the payment is made to an account held by the FFI and maintained by another financial institution, the FFI can provide the withholding agent with an explanatory statement to avoid withholding.

**Nonreporting IGA FFIs.** The final regulations revise the definition of a nonreporting IGA FFI to include entities that are resident of, or located or established in, an IGA jurisdiction that are:

- Described in Annex II of either a Model 1 or Model 2 IGA
A registered deemed compliant FFI
A certified deemed compliant FFI
An exempt beneficial owner

The definition of a certified deemed compliant FFI was also modified to exclude nonreporting IGA FFIs.

An entity meeting the definition of a registered deemed compliant FFI will need to provide a GIIN on its withholding statement. This would include entities meeting the regulatory definition of a certified deemed compliant FFI, but are otherwise classified as nonreporting IGA FFIs.

**Change in circumstance.** The final regulations provide that a withholding agent will not have reason to know that a change in circumstance took place solely because an entity client’s jurisdiction of residence, organization or location is later treated as having an IGA in effect. In lieu of providing a new withholding certificate, the payee in such a situation may provide notification through oral or written confirmation within 30 days of the change and the confirmation must be retained and become a part of the withholding certificate.

In contrast, the temporary regulations provide that a withholding agent will have reason to know a FFI’s chapter 4 status on the date that the jurisdiction where the FFIs is resident, organized, or located ceases to be treated as having an IGA in effect. A withholding agent will have 150 days from the day a jurisdiction is identified as not having an IGA in effect before it is required to treat clients in those jurisdictions as NPFFIs.

Withholding agents will be challenged to identify account holders with documentation on file that may contradict the withholding certificate. For example, account holders could provide a Form W-8BEN-E with the box checked indicating that they are from a Model 2 IGA jurisdiction but could provide an alternative confirmation that they are in a Model 1 jurisdiction.

Currently, the only way to determine whether a jurisdiction’s IGA “in effect” status has changed is by monitoring Treasury’s website.

**Definition of a US person.** The final regulations revise two definitions regarding US persons:

- Individuals that are dual residents in the US and a treaty country and are treated as nonresident aliens (NRAs) under the treaty will be treated as NRAs (not US persons).
- Foreign insurance companies that make a Section 953(d) election and are not specified insurance companies will be considered US persons regardless of whether they are licensed to do business in a state.

**US branches of foreign banks.** The final regulations provide that, when a US branch of a foreign bank is acting as an intermediary and has agreed to be treated as a US person, that branch will be treated as a US person for FATCA purposes, rather than as a foreign financial institution. The US branch will be responsible for withholding, due diligence and reporting as a US withholding agent. The US branch therefore will not be required to provide a GIIN and must provide the employer identification number (EIN) of the branch on a withholding certificate.

US branches that are acting as intermediaries but do not agree to be treated as US persons will also be required to provide withholding agents a certification that the US branch is documenting account holders as if they were PFFIs and reporting all of their US account holders. A withholding agent has until 30 June 2017, to collect such certifications from US branches not treated as US persons.

Withholding agents will need to build a process to begin withholding on 1 July 2017, on an account of a US branch that does not provide its certification. Presumably, the IRS will issue a revised Form W-8IMY to amend line 17 for the certification requirement applicable to a US branch not treated as a US person.

**Foreign branches of US financial institutions.** The final regulations clarify that a foreign branch of a US financial institution is a US withholding agent (USWA) and must comply with the information reporting and withholding obligations imposed on USWAs. Therefore, a foreign branch has primary withholding responsibility on withholdable payments it makes and is not subject to withholding on withholdable payments it receives.

In addition, a foreign branch of a US financial institution that is a Model 1 FFI or a Model 2 FFI may document the chapter 4 status of the payee of a withholdable payment under the Annex I due diligence procedures of the IGA. Accordingly, it may document its account holders under the rules applicable to FFIs located in the same IGA jurisdiction, but must withhold as a US withholding agent.

This is a welcome relief for foreign branches that can document under the same requirements as other non-US financial institutions.
In addition, a foreign branch of a US financial institution that is a Model 1 FFI or a QI is also a FFI. Accordingly, it may document its account holders under the rules applicable to an FFI, but must withhold as a US withholding agent.

This is a welcome guidance from the IRS, which reacted to concerns from the industry pertaining to this provision.

**Withholding statements.** An FFI that provides a withholding statement that allocates a portion of a withholdable payment to a pool of accountholders for whom no reporting is required must provide payee-specific information (including chapter 4 status using the applicable status code for Form 1042-S purposes) and documentation for each payee.

Withholding agents may also want to consider accepting an alternative withholding statement from intermediaries and flow-through entities as discussed later in the chapter 3 section.

**Presumption rules.** The final regulations remain consistent in their application of the presumption rules for a withholdable payment made to an undocumented entity. The preamble clarifies that an FFI in an IGA jurisdiction must also apply these presumption rules if an account holder is undocumented. An FFI that applies the due diligence procedures of Annex I but cannot document an entity's status must apply the presumption rules of the regulations, which would treat the entity as an NPFFI and will require withholding on any withholdable payment made to that entity.

**Entity classification.** The preamble clarifies the interaction between the IGA and regulations for determining an entity's chapter 4 status. The preamble states that an entity determines its status as an FFI or NFFE under the IGA in which it is located or resident. If it is an NFFE, its status as active or passive must be determined under the regulations when it is documenting itself to a withholding agent receiving a withholdable payment.

In other words, an NFFE has to determine its status based on to whom/where it is documenting itself. This is consistent with the instructions to the Form W-8BEN-E which allowed an alternative IGA certification if an entity was documenting its NFFE status for an account maintained in an IGA jurisdiction.

**Nonfinancial group.** The income and asset test for determining whether an entity is an FFI or an NFFE was amended in the final regulations to exclude receivables that are issued to finance customers' purchases of inventory or goods manufactured by a member of the group.

In addition, the final regulations provide that a change affecting the chapter 4 status of a member of a nonfinancial group, or an acquisition by a member of the expanded affiliated group of an FFI that does not have a permissible chapter 4 status disqualifies the group as a nonfinancial group 90 days after the change or acquisition.

**Partnership reporting.** The temporary regulations modify the account reporting requirements that a participating FFI that is a partnership must follow. A participating FFI that is a partnership must report a partner's distributive share of partnership income or loss for the calendar year, without regard to whether any such amount is distributed during the year, and any guaranteed payment for the use of capital.

**Reason to know.** The temporary regulations introduce a responsibility for designated withholding agents of owner-documented FFIs (ODFFIs) to determine if the ODFFI is a member of an expanded affiliated group with any FFI that is a depository institution, custodial institution or specified insurance company.

**Qualified derivatives dealer (QDD).** A qualified intermediary (QI) that is acting as a QDD must provide a Form W8-IMY with a QI-EIN to its withholding agents.

**Active NFFEs.** The final regulations provide clarity to NFFEs as to how to perform the asset test to determine whether they are an active NFFE. An NFFE satisfies the asset test if the weighted average of the percentage of assets held by it that produce or are held for the production of passive income (weighted by total assets and measured quarterly) is less than 50%. Additionally, an NFFE may use any permissible accounting method for purposes of applying the asset test, but must apply a uniform method for measuring assets for the year.

**Final and temporary regulations under chapters 3 and 61 of the Code on withholding of tax from payments to nonresident aliens and reporting payments to US persons**

**Fax/electronic withholding certificates.** Under the former proposed and temporary regulations, for payments made after 6 March 2014, a withholding agent can rely on an electronic transmission (PDF or fax) of a withholding certificate unless it knows that the person transmitting the Form is not authorized to do so by the person required to execute the form. The final regulations modify the effective date of this rule and provide that it applies to any tax year with an open statute of limitations.
This change in the effective date means that a withholding agent that is collecting documentation for prior years, whether as part of a proactive remediation effort or in response to an IRS audit, is not required to collect original “ink-to-paper” withholding certificates.

Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual, can also now be collected electronically.

Electronic signatures. The temporary regulations provide that a withholding agent can rely on an electronic signature received on a withholding certificate even though the withholding agent has not developed and does not maintain an electronic collection system as described in the regulations if the withholding certificate reasonably demonstrates that it was electronically signed by the recipient identified on the form. For example, a signature block that includes a time and date stamp and a statement that the certificate has been electronically signed would be sufficient.

Third-party repositories. The temporary regulations provide that, consistent with IRS FATCA FAQ 11, a withholding agent may rely on an otherwise valid withholding certificate received electronically from a third-party repository if there are processes in place to ensure that the withholding certificate can be reliably associated with a specific request from the withholding agent and a specific authorization from the person providing the certificate for the withholding agent to receive the certificate. In addition, the temporary regulations allow a withholding agent to rely on the withholding certificates and withholding statement provided by an intermediary through a third-party repository. The regulations also require, however, that there are processes in place to update withholding agents when there is a change to such withholding statements, and that the third party cannot be an agent for either the withholding agent or the beneficial owner.

The ability to collect Forms W-8IMY and their underlying documents, including withholding statements, from third-party repositories is a welcome change since the FAQ only applied to beneficial owner withholding certificates, and not certain intermediary withholding certificates.

While the regulations allow a withholding agent to obtain a Form W-8 from a third-party repository, they do not allow for obtaining a Form W-9 from a third-party repository.

Date of birth AND foreign Taxpayer Identification Number (TIN) required. Beginning 1 January 2017, for an account maintained by an individual at a US office or branch of a withholding agent that is financial institution, a beneficial owner withholding certificate must provide both the individual’s date of birth and foreign TIN, if there is one. A withholding agent is not required, however, to treat a withholding certificate as invalid if it does not have the beneficial owner’s date of birth on it, if the withholding agent otherwise has the beneficial owner’s date of birth in its files. Also, beginning 1 January 2018, if a withholding certificate does not provide a foreign TIN, the account holder will be required to provide a reasonable explanation for its absence (e.g., the country of residence does not provide TINs).

The current version of the requester’s instructions to the Form W-8 series indicates that a withholding agent must only collect a beneficial owner’s date of birth if the individual does not provide a foreign TIN. Presumably, the next version of the instructions will be consistent with the new regulations.

Curing late documentation for claims that income is effectively connected with the conduct of a trade or business. A withholding agent can generally collect a “retroactive” withholding certificate if it contains an affidavit stating that the information and representations on the certificate were accurate at the time of payment. The final regulations provide that a retroactive Form W-8ECI must also state that either: (i) the beneficial owner has included the income on its US tax return for the year in which the income should be reported; or (ii) the beneficial owner will include the income on the relevant tax return to be filed, but not due until after the affidavit is signed.

Foreign persons failing to report US-source income that was paid by a withholding agent and represents effectively connected income will need to file either a late or amended income tax return prior to signing a retroactive Form W-8ECI.

US indicia – Form W-8ECI. The final regulations provide that the existence of US indicia on a Form W-8ECI will not cause a withholding agent to have reason to know that the Form is unreliable or incorrect for purposes of establishing the foreign account holder’s status as a foreign person.

Simplified withholding statement of an NQI. The information required to be provided in a withholding statement by an NQI to a withholding agent includes the name, address, TIN and type of documentation furnished
by the NQI for each payee, as well as each payee’s allocable share of each type of income paid by the withholding agent to the NQI and the applicable withholding rate for each of those types of income. The temporary regulations provide that a withholding agent may rely on a simplified withholding statement that does not include all of the information otherwise required by the regulations when that information can be found on the beneficial owners’ withholding certificates. The NQI must certify that none of the information on the beneficial owner withholding certificates is inconsistent with information in the NQI’s files.

Since many withholding statements furnished by NQIs do not meet the technical requirements of the regulations, the ability for a withholding agent to rely on a simplified withholding statement is welcome. Withholding agents will need to be sure, however, that the NQI provides the required certification regarding the lack of inconsistencies between the NQI’s files and the beneficial owner withholding certificates.

**Indefinite validity of documentation.** In order for a withholding certificate to remain valid indefinitely, absent a change in circumstance, the temporary regulations required that documentary evidence be provided together with a withholding certificate. The final regulations provide that documentary evidence and a withholding certificate received from an individual should be received within 30 days of one another in order to support a claim of foreign status that will remain valid indefinitely. Furthermore, documentary evidence and a withholding certificate received from an entity will be valid indefinitely if the withholding agent receives both documents before either the withholding certificate or the documentary evidence would otherwise expire. As in the temporary regulations, however, a treaty claim made on a withholding certificate will not be valid indefinitely.

Most withholding agents have chosen not to treat withholding certificates as “evergreen” because evergreen status does not apply to treaty claims. There is also concern that a withholding agent may not identify a change in circumstance that would otherwise cause the withholding certificate to expire.

**Claim of reduced withholding under an income tax treaty.** The temporary regulations provide that, consistent with the April 2016 version of the Form W-8BEN-E, a limitation on benefits claim must identify the specific treaty provision on which the taxpayer is relying. A withholding agent may rely on such a claim unless it has actual knowledge that the information is incorrect. The regulations specifically provide that a withholding agent will have reason to know that a beneficial owner’s claim to a reduced rate of withholding under an income tax treaty is unreliable or incorrect when the beneficial owner is claiming benefits under an income tax treaty that does not exist or is not in force.

**Bank deposit interest paid to an intermediary or flow-through entity.** Under the final regulations, absent proper documentation, US-source bank deposit interest not subject to chapter 4 withholding paid to a foreign intermediary or flow-through entity is presumed paid to a US nonexempt recipient, and therefore subject to backup withholding. This provision reinstates the presumption rule that was in effect prior to 2014.

**Prior versions of withholding certificates.** The temporary regulations provided that a withholding agent could continue to accept the prior version of a withholding statement that has been revised for a period of six months after the release of the revised version. Under the final regulations, prior versions of withholding certificates may be used until the later of six months after the date of issuance of the most recent withholding certificate or the end of the calendar year during which the revised version was issued.

While this rule applies to Forms W-8, it does not apply to Forms W-9.

**Furnishing Forms 1042-S.** Under the regulations, withholding agents can furnish the recipient copy of a Form 1042-S electronically. Furthermore, whether on paper or electronically, both the recipient’s foreign and/or US TIN can be truncated on the form.

It is important to note that there are strict requirements that apply to furnishing information returns, now including Forms 1042-S, electronically.
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