On 30 December 2016, US Treasury and Internal Revenue Service (IRS) issued proposed regulations under the Foreign Account Tax Compliance Act (FATCA) (REG-103477-14) addressing periodic responsible officer certification and other compliance verification requirements of participating foreign financial institutions (FFIs), compliance financial institutions (FIs) of consolidated compliance programs, sponsoring entities and trustees of trustee-documented trusts. These proposed regulations also describe events of default and termination procedures. The regulations were part of a broader package of FATCA-related guidance that also included final and temporary FATCA regulations and final and temporary regulations under chapters 3 and 61 (T.D. 9808) of the Internal Revenue Code. Those regulations are discussed in EY Global Tax Alert, US IRS and Treasury issue final, temporary and proposed regulations under FATCA as well as chapters 3 and 61, dated 12 January 2017.

**Background**

A participating FFI (including a reporting Model 2 Intergovernmental Agreements (IGA) FFI) must establish and implement a compliance program and to appoint a responsible officer (RO) who must make periodic certifications to the IRS with respect to the FFI’s ongoing FATCA compliance. FFIs covered by a Model 1 IGA are not required to provide periodic responsible officer certifications to the IRS. The obligations of Model 1 IGA FFIs are governed by the laws and requirements of the applicable Model 1 IGA jurisdiction, and the FATCA regulations do not impose verification requirements on such FFIs.
The chapter 4 regulations permit certain FFIs and direct reporting non-financial foreign entities (NFFEs) to be sponsored by other entities for purposes of satisfying their chapter 4 requirements. A “sponsoring entity” performs on behalf of the “sponsored entity” all of the due diligence, withholding, reporting, and other requirements (including certification and other verification requirements) that the sponsored entity would have been required to perform to establish and maintain its applicable FATCA compliant status in accordance with the chapter 4 regulations, FFI agreement or IGA rules applicable to the sponsored entity.

The chapter 4 regulations also permit a participating FFI that is a member of an expanded affiliated group to elect to be part of a consolidated compliance program under the authority of a participating FFI, reporting Model 1 FFI, or US financial institution that is a member of the same expanded affiliated group (compliance FI). The compliance FI must perform the same general duties as a sponsoring entity for all FFIs within its group that elect to be part of the consolidated compliance program.

Proposed changes to the verification requirements and events of default and termination for participating FFIs

Future modification of required certifications. The proposed regulations provide that changes to a participating FFI’s required certification of compliance may be made through an amendment to the FFI agreement. Changes that require any additional information or certifications are to be published at least 90 days before being added to the FFI agreement to allow for public comment.

It is apparent from this provision that the verification and certification requirements will continue to evolve. As the IRS performs its review of the first wave of FATCA reporting and RO certifications, we expect that it will identify areas where additional information would enhance its tax administration of the FATCA requirements and that it will modify the verification and certification requirements accordingly.

Events of default and termination. The proposed regulations would revise the procedures and timeframes for notices of default and terminations applicable to PFFIs as follows:

- Within 30 days of a termination of an FFI’s participating FFI status, the FFI would have to send a notice of termination to each withholding agent from which the FFI receives payments and each financial institution with which it holds an account to which a withholding certificate or other documentation was provided.
- Requests for reconsideration of a notice of default or a notice of termination would have to be made within 90 days of the notice of default or notice of termination.
- An FFI that had its PFFI status terminated would have to obtain written IRS approval before re-registering as a PFFI or deemed compliant FFI.

Resolving a notice of default from the IRS can be a lengthy process, as learned from parallels in the administration of QI agreements. Based on the aggressive time frames for remediation of a default notice, FFIs should expect to need to negotiate extensions of time to resolve these matters.

These proposed regulations also allow the IRS to request additional information and verification steps (including a third-party review) in order to investigate and resolve an IRS claim of an event of default. Careful self-review to determine overall compliance with due diligence and reporting requirements on a periodic basis may minimize risk of an IRS inquiry.

Proposed changes to the verification requirements for consolidated compliance programs

Branches located in Model 1 IGA countries. The proposed regulations would revise the RO certification requirements applicable to a consolidated compliance program to clarify that a branch of an FFI that has elected to be part of a consolidated compliance program is not subject to the periodic review and certification of the program if it is located in a Model 1 IGA jurisdiction.

Certifications for late-joining members. The proposed regulations provide special rules for RO certifications covering FFIs that have elected to be part of a consolidated compliance program but have not been members of the consolidated compliance program for the entire certification period (i.e., joined during the six month period prior to the end of the certification period).
Proposed verification requirements and events of default and termination for sponsoring entities

The proposed regulations would add new paragraphs describing the verification requirements and events of default and termination of sponsoring entities acting on behalf of sponsored investment entities, controlled foreign corporations and closely held investment vehicles and sponsoring entities acting on behalf of sponsored direct reporting NFFEs.

Compliance program and written agreement. A sponsoring entity must maintain a compliance program that includes policies, procedures, and processes sufficient for it to satisfy its obligations as a sponsoring entity as well as the compliance of each of its sponsored entities with the due diligence, withholding and reporting requirements of the chapter 4 regulations, FFI agreement, or IGA rules applicable to such sponsored entities. The proposed regulations would require a sponsoring entity to have in place a written sponsorship agreement with each sponsored entity authorizing the sponsoring entity to fulfill these requirements. A sponsoring entity’s written agreement with a sponsored direct reporting NFFE would also have to include certain specified provisions, including provisions to ensure the sponsoring entity’s access to information necessary to determine the direct and indirect substantial US owners of the sponsored direct reporting NFFE.

Prior regulations did not specify the requirement of a written agreement authorizing the sponsoring entity, and it has not been common practice for sponsoring entities (commonly the asset manager) to prepare written agreements specifically authorizing them to act as the sponsoring entity for FATCA purposes. Current investment management agreements between fund managers and funds are likely sufficiently broad to provide the required authority to fund managers. The execution of written agreements between a fund manager acting as a sponsoring entity and each investment entity for which it acts as a sponsor will likely require tremendous effort.

Responsible officer certifications. Under the proposed regulations, a sponsoring entity would have to appoint a responsible officer (RO) to oversee its FATCA compliance program, covering the compliance of the sponsored entities and the sponsoring entity itself. A sponsored entity would not be required to appoint its own responsible officer. The sponsoring entity’s responsible officer would have to periodically review the sufficiency of its compliance program and the compliance of each sponsored entity with its requirements under the chapter 4 regulations, FFI agreement or an applicable Model 2 IGA. The results of such review would have to be considered by the RO in making required certifications. The RO would have to certify to the IRS by 1 July of the calendar year following the end of each certification period that the sponsoring entity has complied with the requirements to be a sponsoring entity, that it has a written sponsorship agreement in effect with each sponsored entity, and that each sponsored entity meets the requirements of its respective status. In addition, the sponsoring entity’s RO would have to certify that it maintains effective internal controls for all sponsored FFIs for which it acts (or provide a qualified certification) and that, for each sponsored direct reporting NFFE, there have been no events of default (or that such events have been remediated), and that the sponsoring entity has corrected any failures to report on Forms 8966, FATCA Report, for any sponsored direct reporting NFFE.

Certification period. Under the proposed regulations, the first certification period would begin on the later of the date the sponsoring entity is issued a GIIN to act as a sponsoring entity or 30 June 2014, and would end at the close of the third full calendar year following such date. Each subsequent certification period would also be three calendar years.

Certification periods for late-joining sponsored entities. The proposed regulations generally provide that a sponsoring entity must make a certification regarding its compliance with respect to its own requirements and those of all sponsored entities for which it acts during the certification period. There are, however, special compliance period rules when the sponsoring entity has not acted as the sponsor of a sponsored entity for the entire certification period. There are also specific rules for the preexisting account certification for a sponsored FFI that first agrees to be sponsored by the sponsoring entity during the two years prior to the end of the certification period. The preexisting account certification would not be required for certain entities if the entity certified that it already made the preexisting account certification and the sponsoring entity has no reason to know the certification is incorrect.

IRS review. The IRS could request additional information from the sponsoring entity to ensure its compliance with these rules. If the IRS determined that the sponsoring entity may not have substantially complied with its obligations, it could request the performance of specified review procedures by a third party.
At a minimum, we expect the IRS to request a copy of the common policies, procedures and systems that apply for all sponsored entities of the sponsoring entity. Even though Model I IGA FFIs are not subject to the same verification and certification requirements, the compliance approach shared by PFFIs, Model II IGA FFIs and Model I FFIs will give the IRS a view into the compliance of all. It is entirely possible that this will lead to follow-up by the IRS with the relevant competent authorities in foreign jurisdictions.

**Events of default and termination.** The proposed regulations describe occurrences constituting events of default. In the event of a default, the IRS would have the discretion to determine whether, based on the facts and circumstances, an event of default should result in the termination of the sponsoring entity's status with respect to one or more sponsored FFIs. Proposed revisions to the regulations would modify prior rules that provided for revocation of a sponsoring entity's status as a sponsoring entity for all of its sponsored FFIs in the event of default. The IRS could, however, revoke a sponsoring entity's status as a sponsoring entity for all sponsored direct reporting NFFEs if there were an event of default as defined in the regulations for any sponsored direct reporting NFFE. If a sponsoring entity's status is terminated, its sponsored entities may be required to re-register.

The proposed regulations provide timeframes for notices of default and terminations applicable to sponsoring entities that are similar to the timeframes discussed previously for PFFIs. In addition, if a notice of termination were received by a sponsoring entity, within 30 days of the termination, the sponsoring entity would have to send a notice regarding the termination to each of its sponsored entities and to each withholding agent from which the sponsoring entity receives payments and each financial institution with which it holds an account to which a withholding certificate or other documentation was provided.

As described previously, a sponsored entity covered by a Model 1 IGA is not required to comply with the verification requirements of the FATCA regulations, and is governed by the laws and requirements of the applicable Model 1 IGA jurisdiction. The IRS could, however, treat a sponsored entity covered by a Model 1 IGA as an NPFFI if there is non-compliance with the applicable IGA in accordance with local law and such non-compliance is not corrected within 18 months.

Sponsoring entities should be very careful to avoid filing tax refund claims on behalf of sponsored entities without appropriate analysis and documentation supporting entitlement to the refund, as this is currently a key area of scrutiny for the IRS and is a stated event of default in the proposed regulations.

Sponsoring entities should pay close attention to the rate of recalcitrant accountholders of its sponsored entities, as the proposed regulations include in the events of default the failure to significantly reduce recalcitrant accountholders over time.

**Proposed verification requirements for trustees of trustee-documented trusts**

The proposed regulations would add new paragraphs describing the verification requirements of trustees acting on behalf of trustee-documented trusts. The applicable rules for a compliance program and periodic RO certifications are similar to those of a sponsoring entity described earlier. The trustee of a trust that is treated as a trustee-documented trust under an applicable Model 2 IGA, however, has these obligations in its capacity as trustee and is therefore not required to have a written FATCA compliance agreement in place with each covered trustee-documented trust.

In addition, the regulations do not define events of default or provide termination procedures for the trustee of trusts treated as trustee-documented trusts under a Model 2 IGA. The proposed regulations provide, however, that the IRS may request from the trustee additional information on information reported on behalf of trustee-documented trusts or to confirm that the trustee has no such reporting requirements. The IRS may also request additional information to determine the trustee's compliance under an applicable Model 2 IGA or to assist the IRS with its review of account holder compliance with tax reporting requirements. If the IRS determined in its discretion that the trustee may not have substantially complied with its requirements as the trustee of a trustee-documented trust, it could request information from the RO as well as the performance of specified review procedures by a third party. The IRS may also notify the applicable Model 2 jurisdiction that the trustee has not complied with its obligations as the trustee of one or more trustee-documented trusts.
For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, Financial Services Organization

- Debbie Pflieger, Washington, DC  
  +1 202 327 5791  
  deborah.pflieger@ey.com
- Justin O’Brien, New York  
  +1 212 773 4767  
  justin.obrien@ey.com
- Maria Murphy, Washington, DC  
  +1 202 327 6059  
  maria.murphy@ey.com
- Tim Morin, Denver  
  +1 720 931 4488  
  timothy.morin@ey.com
- John Staples, Washington, DC  
  +1 202 327 5662  
  john.staples@ey.com
- Tara Ferris, New York  
  +1 212 360 9597  
  tara.ferris@ey.com
- Dawn McGuire, Boston  
  +1 617 375 3737  
  dawn.mcguire@ey.com
- George Fox, Washington, DC  
  +1 202 327 5621  
  george.fox@ey.com
- Doug Sawyer, New York  
  +1 212 773 8707  
  douglas.sawyer@ey.com
- Phil Garlett, Washington, DC  
  +1 202 327 5809  
  philip.garlett@ey.com
- Jonathan Jackel, Washington, DC  
  +1 202 327 5725  
  jonathan.jackel@ey.com
- Lisa Chavez, Chicago  
  +1 312 879 2331  
  lisa.chavez@ey.com
- Todd Larsen, Philadelphia  
  +1 215 448 5606  
  todd.larsen@ey.com

Ernst & Young LLP, International Tax Services

- Lilo Hester, Washington, DC  
  +1 202 327 5764  
  lilo.letcher@ey.com
- Brian Dunkel, Atlanta  
  +1 404 817 4410  
  brian.dunkel@ey.com

International Tax Services

Global ITS, Alex Postma, Tokyo
ITS Director, Americas, Jeffrey Michalak, Detroit
ITS Markets Leader, Americas, Stephen O’Neil, New York
Ernst & Young LLP, National Director of ITS Technical Services, Jose Murillo, Washington

ITS Regional Contacts, Ernst & Young LLP (US)

Northeast
Johnny Lindroos, McLean, VA

Financial Services
Chris J Housman, New York

Central
Mark Mukhtar, Detroit

Southeast
Scott Shell, Charlotte, NC

Southwest
Amy Ritchie, Austin

West
Beth Carr, San Jose, CA

Canada - Ernst & Young LLP (Canada)
Albert Anelli, Montreal
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About Ernst & Young's International Tax Services practices
Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

International Tax Services

© 2017 EYGM Limited.
All Rights Reserved.
EYG no. 00168-171US
1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com