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MAKING SENSE OUT OF FATCA

Essential Concepts to Understand the "Chapter 4" Withholding Rules and Regulations and the Inter-Governmental Agreements

(With Special Reference to the Likely Provisions of the USA-Israel Intergovernmental Agreement)

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I. INTRODUCTION: THE NATURE, GENESIS AND PRIMARY PURPOSE OF FATCA

The Chapter 4 withholding tax is a mechanism intended to deter U.S. investors from hiding assets outside the U.S.A. to avoid U.S. tax on these investments but, in point of fact, the tax is primarily imposed not on U.S. persons but on non-U.S. financial institutions[2] and some other non-U.S. non-financial entities[3] if they do not agree to engage in a program of disclosure about their depositors and investors to the IRS similar to — and even exceeding — the disclosure with which U.S. financial and other paying entities are required to comply about domestic taxpayers. The tax represents a flat 30% withholding on payments of U.S. source FDAP investment income, the gross proceeds of the sale of U.S. assets held for investment that give rise to FDAP income (defined as "withholdable payments") and certain so-called "foreign pass-thru payments," which essentially negates all the forms of statutory and treaty relief from U.S. withholding tax on non-resident aliens and non-U.S. corporations that have been a feature of U.S. tax law for many years. It needs to be carefully distinguished from the Chapter 3 withholding tax, which is designed to be the chief – and in an ideal world would still be the only — form of U.S. tax collection on generally "passive" payments of U.S. source income and gains to persons who are not required to file U.S. income tax returns because they are not U.S. citizens or residents and also do not receive income that is "effectively connected to a U.S. trade or business," which would otherwise require the filing of a non-resident U.S. tax return.[4]

The reason why the 30% withholding tax under Chapter 4 has such a potential "in terrorem" effect is that the 30% withholding tax imposed under Chapter 3 on non-U.S. investors or U.S. source income has essentially been undergoing a "disappearing act" under regular U.S. foreign withholding tax rules: no U.S. capital gains tax is imposed on the direct sale of U.S.

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[2] IRC § 1471(a).

[3] IRC § 1472(a).

[4] IRC §§ 1441-1446.

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assets (other than certain interests in U.S. real property);[5] generally, very little or no U.S. tax is imposed on payments of interest from U.S. bank accounts and interest from U.S. "portfolio" debt instruments;[6] often, no withholding tax is imposed on royalty income when a U.S. bilateral income tax applies;[7] and usually lower rates of U.S. tax apply to dividends paid to non-U.S. shareholders by U.S. corporations when a bilateral income tax treaty applies.[8] All of these forms of tax relief to non-U.S. persons are eliminated by the Chapter 4 withholding tax and the ability of an innocent foreign investor to recoup any excess of the Chapter 4 withholding tax over the normal Chapter 3 withholding tax is circumscribed by various substantive and procedural limitations and requirements.[9]

Even after the enhancement of the U.S. withholding tax regime on payments of U.S. source investment income to non-U.S. investors by the institution of the qualified intermediary program at the beginning of the last decade, officials in the U.S. Government were concerned that the withholding regime was not fully effective to raise foreign or "non-resident alien" withholding tax and that at least some U.S. tax payers with non-U.S. investments could improperly avoid U.S. tax on their non-U.S. investments. A December 2007 Report of the United States Government Accountability Office ("GAO") evaluated the qualified intermediary program under which foreign financial institutions undertake with the U.S. Internal Revenue Service to withhold and report U.S. source income sent to their non-U.S. customers and clients and concluded that a relatively small percentage of U.S. source income flows through qualified intermediaries (sometimes referred to as "QI"s). The report further notes that "[i]ndirectly owned account identity information received from NQIs (i.e., non-U.S. banks and other financial centers that have not agreed with the IRS to serve as "qualified intermediaries") is a particular

[5] IRC §§ 865, 871(a)(2) and 897.

[6] IRC § 871(h). Article 13 of the U.S. Israel Income Tax Treaty provides for withholding tax rates on certain payments of interest that are substantially lower than the 30% withholding tax rate that would apply in certain situations where the portfolio interest exemption under IRC § 871(h) would not apply.

[7] See e.g., Art. XII of the U.S. – Canada Income Tax Treaty.

[8] Art. XII of the U.S.-Israel Income Tax Treaty. While the withholding tax rate of 30% under Chapter 4 is not as high as the highest individual U.S. income tax rate of 39.6% (IRC § 1(a) – (e)) on U.S. resident individuals or the highest U.S. corporate income tax rate of 35% on U.S. resident corporations (IRC §11), it may often come close, as a flat tax, to approximating the effective rate of U.S. tax on the ordinary investment income of U.S. investors and far exceeds the highest U.S. individual capital gains tax rate on capital gains of 20% (IRC § 1(h)).

[9] See IRC § 1474 and the regulations thereunder discussed briefly below in Section VII.

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weakness because, unlike QIs who contractually agree to verify W-8BEN information with know your customer information, NQIs may accept W-8BENs at face value and forward them to U.S. withholding agents." Therefore, the Report concludes, "indirect accounts" — that is, accounts of persons who do not have a direct relationship with a U.S. withholding agent — "expose the withholding agent and reporting activity to a greater potential for granting of tax exemptions or treaty benefits due to misinformation or fraud." The GAO report commented on information available to the IRS, suggesting that many transactions reported by U.S. withholding agents and qualified intermediaries with unknown jurisdictions or unknown recipients "may reflect billions of dollars without proper documentation or reporting to IRS, since eligibility for a reduced rate of withholding must be determined by the claimant's documented nationality, residency and type of investment."

Consequently, the GAO recommended that the IRS "[d]etermine why U.S. withholding agents and QIs report billions of dollars in funds flowing to unknown jurisdictions and unknown recipients," and, based on this determination, "take appropriate steps to recover any withholding taxes that should have been paid and to better ensure that U.S. taxes are withheld when account holders do not properly identify themselves." (Emphasis added.) The GAO Report, which was issued coincidentally almost on the eve of the disclosure in 2008 of the activities of UBS and other foreign banking institutions to assist U.S. investors in hiding funds from the IRS, may have been soon forgotten, save for the shock waves emanating from the UBS scandal. Looking for ways to prevent such schemes of tax evasion from recurring, it was a natural response by Congress and the President to seize on the weaknesses in the Chapter 3 withholding regime and the 2000 "QI Program" identified by the GAO Report and to implement a new withholding and disclosure regime designed, in large part, to remedy the deficiencies identified by the GAO.

Notwithstanding all the attention given to the return of the Chapter 4 as a withholding tax, therefore, the real purpose of FATCA is to encourage foreign financial institutions to determine who of their account holders and investors are "specified U.S. persons" (generally any individual who is a U.S. citizen or resident or any entity considered a U.S. domestic entity (subject to a relatively narrow range of exceptions – see Exhibit I for a list of

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such exceptions))[10] and to disclose that information (together with information about payments made by the foreign financial institutions to their U.S. investors and account holders) to the IRS.[11] If every foreign financial institution were to successfully complete the due diligence and reporting responsibilities envisaged by FATCA, not one dollar of Chapter 4 withholding tax should be collected. In fact, the FATCA regulations give foreign financial institutions the option to engage in the same due diligence and "back-up" withholding obligations required of U.S. financial institutions with regard to their U.S. depositors and investors under Chapter 61 of the IRS.[12] While it is not expected that many financial foreign institutions will take up this offer of the IRS, the FATCA regime seems essentially designed to make available to the IRS as much or even more information about payments to U.S. account holders and investors by foreign financial institutions than the IRS requires U.S. financial institutions to make available to it.

The proliferation of inter-governmental agreements in response to FATCA does not change the fundamental aim of the FATCA regime. Under Model I IGAs, the "reporting" financial institutions of Model I IGA countries provide information regarding their U.S. account holders and investors to their respective governments, who then transmit the information to the IRS – in the case of a reciprocal Model I IGA like the UK and Israel Agreements, with the USA reciprocally providing information about the other country's taxpayers to them. Under Model II IGA's like the Swiss and Japanese Agreements, the financial institutions of Model II IGA countries are directed to provide information regarding U.S. account holders and investors to the IRS much in the same way as provided in the FATCA regulations but the procedure for dealing with "non-consenting" or "recalcitrant account holders" and so-called "non-participating foreign financial institutions" vary. Under exchange of information protocols with the United States, Model II IGA countries agree (subject to various procedural safeguards) to make available to the IRS information about U.S. account holders and investors with financial institutions in their countries who refuse to cooperate with them to carry out their FATCA due diligence. Under both Model I and Model II IGA's, reporting financial institutions are generally exempt from any obligation to withhold and collect withholding tax under Chapter 4 with respect to non-

[10] IRC § 1473(3).

[11] IRC § 1.1471(b).

[12] IRC § 1471(c)(2) and TR § 1.1471-4(d)(5).

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consenting or recalcitrant account holders, as long as the partner jurisdiction and its financial institutions abide by the terms of the IGA; in the case of Model 1 IGA's, qualified intermediaries, withholding partnerships and withholding trusts are required to withhold the Chapter 4 tax on non-participating foreign financial institutions resident outside the partner jurisdiction but generally not on non-participating institutions in the partner jurisdiction itself.

II. FOREIGN FINANCIAL INSTITUTIONS AND FATCA: THEIR CENTRAL ROLE IN THE CHAPTER 4 REGIME

Foreign financial institutions that agree to participate in the Chapter 4 reporting regime are generally required to enter into a formal agreement with the IRS binding themselves to apply the statutory and regulatory provisions of FATCA and to register on an online portal that will generate unique identification numbers for each of them (so-called ("GIINS").[13] These numbers will appear in periodic public announcements of the IRS, which will be carefully scrutinized by U.S. withholding agents, non-U.S. qualified intermediary withholding agents, and any other non-U.S. financial institutions that have residual withholding responsibility for the Chapter 4 tax. Beyond the world of foreign financial institutions, so-called "passive" non-financial non-U.S. entities (defined as non-financial entities whose income from passive investments exceed 50% of their income or more than 50% of whose accounts are of a passive nature), while not needing to engage in the extensive compliance required of "participating foreign financial institutions" under the FATCA regulations and "reporting financial institutions" under the intergovernmental agreements, must still disclose information about their "substantial U.S. investors" (generally 10% stakeholders) to the relevant U.S. withholding agent, qualified intermediary or other non-U.S. withholding agent directly to the IRS to avoid imposition of the Chapter 4 tax.[14]

Before discussing the nature and responsibilities of foreign financial institutions within the FATCA regime, it is important to remember that there is a vast population of foreign institutions and entities that are formally or effectively exempt from Chapter 4 withholding and whose only obligation or recommended course of action under FATCA may be to complete and

[13] IRC § 1.1471(b)(1), TR § 1.1471-4. See also IRS Notice 2014-13 for the IRS's formal draft of a foreign financial institution agreement.

[14] TR § 1.1472-1(a) *et seq*.

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deliver to an authorized withholding agent a Form W-8EXP or Form W-8BEN-E or a self-certification of a similar nature. The categories of these formally or effectively exempt foreign institutions and entities include "exempt beneficial owners" such as foreign governments, international organizations, and certain retirement funds,[15] "excepted non-financial foreign entities" such as publicly traded corporations not primarily engaged in financial services and related activities,[16] and "excluded entities" such as certain holding companies, non-financial start-up companies and non-profit organizations. (For a more complete list of foreign entities not subject to Chapter 4 withholding, please see Exhibit II.) Each intergovernmental agreement, it should be noted, also contains in Annex II a list of "non-reporting" institutions, which generally tracks the categories of institutions and entities considered to be exempt or excluded under the FATCA regulations, with the addition of specific local government, retirement and other organizations. (A sample list of exempt and excluded organizations under an inter-governmental agreement is attached as Exhibit III).

A "foreign financial institution" is generally any entity organized outside the United States or otherwise considered to be "non-U.S." that accepts deposits in the ordinary course of a banking or similar business, holds financial assets for the account of others as a substantial portion of its business, or is engaged primarily in the business of investing, reinvesting or trading securities, partnership interests, commodities or any interest in them.[17] The FATCA regulations, using an implied authority granted in the statutory definition of "financial institution," widens the scope of the concept by incorporating in the regulatory definition of "financial institution" insurance companies offering certain cash value insurance and annuity products and certain holding companies and treasury centers that are parts of "expanded affiliated groups" (discussed below) that contain depositary and custodial institutions, insurance companies and investment entities."[18] The regulatory definition of "investment entities," a subcategory of "financial institutions," is itself very broad, defining "business" as any

[15] TR § 1.1471-6(a) *et seq*.

[16] TR § 1.1472-1(c)(1).

[17] IRC § 1471(d)(5) and TR § 1.1471-5(d) *et seq*.. The definition of who or what is a "U.S." person (either individual or entity) follows the definition in IRC § 7701(a)(30) and the regulations thereunder. TR § 1.1471-1(b)(132).

[18] TR § 1.1471-5(e)

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entity primarily engaging in trading financial instruments and assets, individual or collective portfolio management or otherwise investing, administering or managing money or financial assets under the management of another financial institution if the entity's gross income attributable to such activity equals or exceeds 50% of the entity's gross income during the shorter of a three year period or the period during which the entity has been in existence.[19]

The examples contained in the FATCA regulations make clear that a non-U.S. trust managed by a professional trust company would qualify as an investment vehicle and therefore as a foreign financial institution while a trust managed by a private individual would not qualify as an investment vehicle and therefore not as a foreign financial institution (although the latter may well qualify as a "passive" non-financial foreign entity).[20] While the FATCA regulations issued in January 2013 provided that a person treated as a trust grantor under the "grantor trust rules" of the Internal Revenue Code would be treated as the owner of that trust's accounts, the February 2014 Temporary Regulations provide that "if a trust (including a single or grantor trust) or an estate is listed as the holder or owner of a financial account, the trust or estate is the account holder, rather than its owners and beneficiaries.[21]

Relevant to the determination of whether some institutions are subject to Chapter 4 and what types of accounts must be disclosed is the concept of "substantial U.S. owner." Of interest primarily to the determination of whether a non-financial foreign entity has any FATCA disclosure obligation is whether a foreign corporation or foreign partnership has any "substantial U.S. owners," defined as any specified U.S. person that owns, directly or indirectly, more than 10 percent of the stock or profits interests or capital interests in such entity.[22] For purposes of foreign trusts, a "substantial U.S. owner" is any U.S. person treated as the owner of the trust under U.S. income tax concepts or who holds directly or indirectly more than 10 percent of the beneficial interest in the trust.[23] But for foreign financial institutions that qualify as "investment

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[19] TR § 1.1471-5(e)(4)(iii).

[20] TR § 1.1471-5(e)(4)(v) (Ex. 6).

[21] 2014 Temp. Reg. § 1.1471-5-(a)(3), revising Final TR § 1.1471-5(a)(3). Note that under TR § 1473-1(b)(4)(ii), a trust that is treated as owned only by U.S. persons under the U.S. grantor trust income tax rules is not required to list any of its beneficiaries as substantial U.S. owners.

[22] TR 1.1473-1(b)(1)(i)-(ii).

[23] TR 1.1473-1(b)(1)(iii).

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entities," a "substantial U.S. owner" is any specified U.S. person regardless of their percentage economic interest in the entity.[24]

The FATCA regulations generally allow reporting financial institutions that qualify as "Reporting Model 1 FFIs" to be relieved of FATCA requirements inconsistent with the terms of their respective inter-governmental agreements and to be therefore treated under the FATCA regulations as "deemed compliant" foreign financial institutions.[25] The FATCA regulations accord the same basic treatment to "Reporting Model 2 FFIs" (although the degree of relief from the FATCA requirements for Model 2 institutions mainly consists of exemption from the Chapter 4 withholding rules on recalcitrant account holders but not on non-participating foreign financial institutions and certainly not on the Chapter 4 account reporting rules).[26] The FATCA regulations also allow a relatively small sub-set of foreign financial institutions not covered by any intergovernmental agreement to be "deemed compliant" and therefore relieved from the regular FATCA reporting requirements about their account holders and, in most instances, from the FATCA withholding requirements as well because the U.S. Treasury believes it is unlikely they will have very many U.S. depositors or investors.[27]

Deemed compliant foreign financial institutions include "registered deemed compliant" and "certified deemed compliant"[28] institutions as well as certain forms of "owner-documented" institutions. A registered deemed compliant institution must register with the IRS (but need not enter with IRS into a foreign financial institution agreement)[29] while a certified deemed-compliant institution or an owner-documented institution will not be required to do so.[30]

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[24] TR 1.1473-1(b)(5). Application of the "substantial owner" concept in the case of trusts is challenging. It includes any U.S. person treated as an owner of any portion of a trust under IRC §§ 671-679, and any specified U.S. person that holds, directly or indirectly, more than 10% of the beneficial interests in a trust. TR § 1.1473-1(b)(1)(iii). But TR § 1.1473-1(b)(5) appears to require that the 10% threshold be ignored in the case of a trust that qualifies as a foreign financial institution under the investment entity category because it has a corporate trustee or its investments are professionally managed. It should be noted that most non-U.S. private investment companies held by trusts likely qualify as foreign financial institutions because they fit into the "investment entity" category.

[25] TR § 1.1471-5(f)(1) (second sentence).

[26] TR § 1.1471-5(f)(1) (first sentence).

[27] TR § 1.1471-5(f).

[28] TR § 1.1471-5(f)(1).

[29] TR § 1.1471-5(f)(1)(ii).

[30] TR § 1.1471-5(f)(2) (last sentence).

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Any "Model 1 FFI" that complies with the requirements of the registration requirements under its respective intergovernmental agreement is considered to be a registered deemed-compliant institution and any "Model 2 FFI" that complies with certain procedural requirements under the FATCA regulations (including not only registering with the IRS but, on a triennial basis certifying to the IRS that all the requirements of its status have been met) will be also considered a registered-deemed compliant institution.[31] As a result, Model 1 and Model 2 institutions are "deemed" to have fulfilled all the requirements of IRC Sections 1471(b) and therefore to be exempt from the Chapter 4 withholding tax.[32] (A list of types of registered and certified deemed compliant institutions is attached as Exhibit IV.)

An "owner-documented FFI" is a foreign financial institution for whom a designated withholding agent (which can be a U.S. financial institution, a qualified intermediary, a participating FFI or a model FFI or a non-U.S. entity) has agreed to exercise due diligence and collect documentation provided by the owner-documented FFI and an "FFI owner reporting statement" that provides the withholding agent with all the information it is required to agree to provide the IRS about individual and specified U.S. persons who own direct or indirectly equity in the institution or who owns a debt instrument of the institution.[33] An FFI can qualify as an "owner-documented FFI" only if it qualifies as an investment entity; it appears that an FFI that qualifies as a depository institution or custodial institution would not qualify.[34] Since a foreign financial institution can only qualify as "owner-documented" with regard to a specific withholding agent, it appears that the special regime made available to "owner-documented FFIs" will not be very useful to institutions that receive U.S. source income from multiple payors unless the withholding agent is a custodian that has essentially undertaken withholding responsibility for all U.S. assets held by the owner-documented FFI.

The FATCA regulations also provide a few options for structuring the relationship between foreign financial institutions and withholding agents that may result in a

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[31] TR § 1.1471-5(f), referencing TR § 1.1471-5(f)(1)(ii).

[32] TR § 1.1471-5(f). Exemption from the Chapter 4 withholding tax, of course, does not mean exemption from any Chapter 3 withholding tax obligations it may be separately subject to.

[33] TR §§ 1.1471-5(f)(3)(i), 1.1471-3(d)(6).

[34] TR § 1.1471-5(3)(ii)(A) & (B).

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more streamlined and less burdensome cost of compliance, including “sponsored investment entities” and “sponsored closely held investment vehicles.” Sponsored investment entities are registered deemed-compliant foreign financial institutions and include certain investment entities that are not qualified intermediaries, withholding partnerships or withholding trusts when another entity has agreed to serve as a sponsoring entity for them.[35] They also include certain sponsored controlled foreign corporations that are wholly-owned by U.S. financial institutions that agree to serve as sponsoring entities and share common electronic accounts systems with the sponsored entities. In all cases, sponsoring entities must be authorized to manage the sponsored entity and perform all FATCA duties as if the sponsored entities were participating foreign financial institutions. Finally, the sponsored entity as well as the “sponsoring entity” must be registered with the IRS.

Sponsored closely held investment vehicles, on the other hand, are certified deemed-compliant foreign financial institutions.[36] They are investment entities under the FATCA rules that are not qualified intermediaries, withholding partnerships or withholding trusts, and have contractual agreements with a sponsoring entity that is a participating FFI, a Model 1 FFI or U.S. financial institution that assumes all FFI due diligence withholding and reporting responsibilities for them. A key requirement is that generally no sponsored closely held investment vehicle may have more than 20 individuals owning debt and equity interests in the vehicles. Thus, non-U.S. trusts with a common corporate trustee could qualify as sponsored, closely held investment vehicles without registering with the IRS as long as they can claim that they have no more than 20 beneficiaries (a seemingly insurmountable goal for many non-U.S. trusts with hosts of future contingent beneficiaries) but non-U.S. trusts that qualified as sponsored investment entities would need to register with the IRS. Under a change introduced by the 2014 Temporary Regulations, a sponsoring entity must also meet the same verification requirements that are required of participating financial institutions, which are described in Section III(G) of this article below.[37]

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[35] TR § 1.1471-5(f)(1)(i)(F).

[36] TR § 1.1471-5(f)(2)(iii).

[37] TR § 1.1471-5(f)(2)(iii).

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The U.S. Treasury was concerned that a group of affiliated foreign financial institutions might be able to avoid the compliance objectives of Chapter 4 compliance by shifting accounts between affiliates and "cherry-picking" which affiliates would be FATCA compliant. Therefore, the U.S. Treasury will only enable a foreign financial institution to qualify as a "participating foreign financial institution" (and thus have the opportunity to escape the Chapter 4 withholding tax) if all of its affiliates also qualify as participating foreign financial institutions, registered deemed compliant foreign financial institutions or exempt beneficial owners by December 31, 2015.[38] For the purpose of determining whether foreign financial institutions are affiliated, the IRS has adopted essentially the same test it uses to determine if a group of affiliated U.S. corporations qualify to file a consolidated U.S. income tax return under IRC Section 1504(a), but applying a 50% rather than an 80% test to determine if the different institutions have the same ultimate common voting control and ownership.[39] The same essential requirement has been imposed on single foreign financial institutions that have branches: all such branches must be compliant by the end of 2015 unless otherwise provided pursuant to a Model 1 or Model 2 IGA.[40] Thus, the draconian effects of the December 31, 2015 deadline are deflected for foreign financial institutions organized in jurisdictions that are parties to inter-governmental agreements as long as the non-conforming affiliates or branches essentially do as much as they can under the laws of the jurisdictions to which they are subject to conform to U.S. requirements.[41] It should also be remembered that an entity that is a member of an affiliated group or "participating FFI group" is excluded from Chapter 4 withholding if it does not maintain any financial accounts and does not hold an account with or receive payments from any withholding agent other than a member of its expanded affiliated group.[42]

III. CHAPTER 4 REPORTING OF FOREIGN FINANCIAL INSTITUTIONS UNDER THE FATCA REGULATIONS

As already noted, the primary purpose of FATCA is <u>not</u> to withhold tax but to have non-U.S. financial institutions cooperate with the IRS in gathering information about U.S.

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[38] TR 1.1471-4(e).

[39] TR § 1.1471-5(i)(2).

[40] TR § 1.1471-4(e)(2).

[41] *See* e.g., likely U.S.-Israel IGA Article 4(5).

[42] TR § 1.1471-5(e)(5)(iv).

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investors and depositors and their respective income and gains – much as U.S. financial institutions have been required to do for many years – and engage in information collecting and due diligence procedures that will ensure the accuracy and sufficiency of the disclosure made to the IRS. Implementation of the FATCA reporting requirements for participating foreign financial institutions requires making a distinction between individual and entity accounts and between accounts existing as of the date of the FATCA commencement date (generally July 1, 2014), which are referred to in the FATCA regulations as "pre-existing accounts," and accounts opened up on or after the commencement date.[43]

A. Pre-Existing Individual Accounts. Generally, *depositary* accounts with a value of *$50,000 or less* are not subject to FATCA reporting requirements because they are defined, by regulation, as not qualifying as U.S. accounts.[44]

Participating foreign financial institutions are also exempt from conducting due diligence on pre-existing individual accounts to identify U.S. account holders that are *not depositary accounts* as well as *annuity contracts and cash value insurance contracts* owned by individuals where the value is *$250,000 or less*.[45] The due diligence required for identifying pre-existing accounts exceeding $50,000 but not exceeding $1 million (sometimes referred to as "low-value accounts") is generally limited to a review of electronic information available to the financial institution.[46] Greater due diligence, including examination of paper records, is required for pre-existing individual accounts with a value of more than $1 million (sometimes referred to as "high-value accounts"). The aim of the due diligence is to establish if there are any "U.S. indicia" applicable to each account and to obtain further documentation, if necessary, to establish the Chapter 4 status of the account.[47] Generally, due diligence for pre-existing individual accounts that are high value accounts must be completed by one year from the effective date of

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[43] TR §§ 1.1471-1(b)(102), 1.1471-1(b)(104).

[44] TR § 1.1471-5(a)(4). Note, that generally, in determining the aggregate balance or value of an account, a financial institution is required to aggregate the account balance or value of all accounts held (in whole or in part) by the same person and that are maintained by the financial institution or members of its expanded affiliated group. TR § 1.1471-5(b)(4)(ii).

[45] TR § 1.1471-4(c)(5)(iii).

[46] TR § 1.1471-4(e)(5)(iv)(A)-(C).

[47] TR § 1.1471-4(e)(5)(iv)(D).

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an FFI Agreement and due diligence for pre-existing accounts that are not high value accounts must be completed within two years of the effective date of an FFI Agreement.[48]

B. Pre-Existing Entity Accounts. Due diligence is excused for pre-existing entity accounts owned by *entities* with a value not exceeding *$250,000*, as long as no owner has been previously identified as a U.S. person but this exemption ceases to apply in any subsequent year when the account balance exceeds $1 million.[49] The due diligence requirements for pre-existing entity accounts are largely the same as for new entity accounts described below. Due diligence on accounts or investments held by so called "prima facie" FFIs must be completed within six (6) months of FFI Agreement effective date. A prima facie FFI is a financial institution with a U.S. account that is formally on record electronically with a withholding agent as being a qualified intermediary or, under the presumption rules discussed below, is a non-U.S. entity or is documented as a non-U.S. entity for purposes of Chapter 3 withholding (FDAP withholding non-U.S. payees) or Chapter 61 withholding (back-up withholding for U.S. payees) and has been identified as a financial institution by the agent using the electronically searchable information available to it.[50]

C. New Individual Accounts. The most secure method for identifying individual account holders and investors is to have each account holder or investor complete a relevant IRS withholding certificate or obtain the information requested on an IRS withholding certificate in a form that is similar to an IRS withholding certificate even if there is nothing on the form that suggests a U.S. origin or function.[51] However, the FATCA regulations give foreign financial institutions alternatives for determining the status of individual account holders and investors to that of obtaining a withholding certificate or substitute certificate.[52] These include

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[48] TR § 1471-4(c)(5), referencing TR § 1471-5(g)(3)(i) or (ii).

[49] TR § 1.1471-4(c)(3)(iii).

[50] TR § 1.1471-4(c)(3)(ii).

[51] TR § 1.1471-3(c)(6)(v)(A). That the FATCA regulations allow such a substitute form shows the resourcefulness of the FATCA regulation authors in light of the general panic often experienced where a non-U.S. person or institution is asked to complete documentation that foreign persons think (rightly or wrongly) will put them "on the U.S. radar screen."

[52] TR § 1.1471-4(c)(4)(i), referencing TR § 1.1471-3(c)(5) (documentary evidence such as certificates of tax deadlines, government-insured identification, QI documentation, government-issued entity documentation, and third party credit reports), TR § 1.1471-4(c)(4)(ii) (information provided by third party credit agencies) and 4(iii)(A) (alternative documentation for certain cash value and annuity contracts), and withholding certificates.

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certificates of residence issued by a local taxing authority,[53] government-issued identification documents,[54] and certain third-party credit reports.[55] (For a more detailed list of forms of documentary evidence allowed for individual accounts and to resolve inconsistencies and other issues raised by the documentation offered by account holders and payees, see Exhibit V.)

D. New Entity Accounts. For entity accounts in general, the IRS essentially requires participating foreign financial institutions to apply the same documentation requirements as are imposed for Chapter 4 purposes on withholding agents.[56] Thus, the major method for foreign financial institutions to complete their due diligence regarding their entity account holders and investors that are entities is to have each account holder or investor complete an applicable IRS withholding certificate, or obtain the information requested on an IRS withholding certificate in a form that is similar to an IRS withholding certificate, even if there is nothing on the form that suggests a U.S. origin or function.[57] The key requirement is that the certificate or substitute form, in the case of a Form W-9 (for a U.S. owner), must be signed under penalties of perjury by or on behalf of the entity[58] and, in the case of a Form W8-BEN (for a non-U.S. owner other than an intermediary, flow-through entity, qualified intermediary, etc.) must be signed, under penalties of perjury, by or on behalf of the entities that are beneficial owners of the accounts or investments.[59] Similar certificates must be signed under penalties of perjury by the authorized representatives of non-U.S. entities that are considered to be acting as "intermediaries" or "flow-through" entities (Form W-8IMY),[60] exempt entities (Forms W-8EXP),[61] or entities whose only U.S. source income qualifies as "income effectively connected with a U.S. trade or business" as distinguished from U.S. source FDAP income (Form W-

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[53] TR § 1.1471-3(c)(5)(i)(A).

[54] TR § 1.1471-3(c)(5)(i)(B).

[55] TR § 1.1471-3(c)(5)(i)(E), subject to TR § 1.1471-4(c)(4)(ii).

[56] TR § 1.1471-4(c)(3)(i), referencing TR § 1.1471-3(b), (c), and (d).

[57] TR § 1.1471-3(c)(6)(v)(A). Again, the allowance of a substitute form is wise in light of the general reaction of panic often experienced when non-U.S. persons or institutions are asked to complete documentation they think (rightly or wrongly) will put them "on the U.S. radar screen."

[58] TR § 1.1471-3(c)(3)(i).

[59] TR § 1.1471-3(e)(3)(ii).

[60] TR § 1.1471-3(c)(3)(iii).

[61] TR § 1471-3(c)(3)(iv).

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8ECI).[62] (See Exhibit VI for a more detailed list of the documentation requirements for each category of non-U.S. entity as denominated in the FATCA regulations.)[63]

E. Standards of Review. It is important to grasp that a foreign financial institution may not adequately discharge its FATCA responsibilities only by collecting withholding certificates and other forms of documentary evidence but must apply standards of knowledge designed to require additional due diligence when a withholding certificate or other form of documentary evidence claiming non-U.S. status for an account holder or investor is inconsistent with other information available to the institution.[64] These standards, which are based on the standards imposed on Chapter 4 withholding agents, are generally designed to require participating foreign financial institutions to be alert for "red flags" about the claimed non-U.S. status of an account holder or investor when the institution's own records indicate that a person may have various connections to the United States that bely that person's claims of non-U.S. status (for a more detailed description of these standards, see Exhibit VII.)

After reviewing all appropriate documentation collected about its entity depositors and investors and applying the just-mentioned standards of knowledge to such documentation, a participating financial institution must apply certain "presumptions" to determine the status of an entity account holder or investor whose status is still unclear.[65] In order to reduce confusion, the U.S. Treasury Department decided earlier this year that the presumptions should, for the most part, be consistent with the presumptions for Chapter 13 foreign or "non-resident alien" withholding tax.[66] (For further details, see Exhibit VIII.) In the case of pre-existing accounts the foreign financial institution must also review all information collected when the account was opened and apply the standards of knowledge referenced above. However, unlike the case of entity owners, the foreign financial institution may not apply the

[62] TR § 1471-3(c)(3)(v).

[63] Withholding certificates are generally valid for a three year period, TR § 1471-3(c)(6)(ii)(A), but certificates issued by certain participating foreign financial institutions, non-U.S. individuals and foreign governments and others may be valid indefinitely as long as there is no knowledge of a change of circumstances that could make the information on the documentation incorrect. TR § 1.1471-3(c)(6)(ii)(B).

[64] TR § 1.1471-4(c)(2)(ii), referencing TR § 1.1471-3(e).

[65] TR § 1.1471-4(c)(3)(i), referencing TR § 1.1471-3(c), including presumption rules of TR § 1.1471-3(f).

[66] TR § 1.1471-3(f)(3).

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aforementioned presumptions to pre-existing individual accounts[67] but must either establish that the account is a U.S. account or treat the holder of such account as a recalcitrant account holder.[68]

F. Reporting to the IRS. Once having gathered information and reviewed it subject to IRS requirements, each participating foreign financial institution must report to the IRS information each year about the payments it makes to the following account holders: specified U.S. persons, non-financial foreign entities considered to be "U.S. owned," owner-documented foreign financial entities and "recalcitrant account holders."[69] The category of "recalcitrant account holder," in turn, is intended to cover four sub-categories: holders of accounts who does not cooperate with a foreign financial institution in documenting the account holder's status for Chapter 4 purposes, holders of accounts who fail to provide a form W-9 when requested, account holders who fail to obtain a waiver of local law restraining them from disclosing information about their Chapter 4 status, and certain non-financial foreign institutions that fail to disclose information regarding their U.S. substantial owners.[70] The annual U.S. return of any participating foreign financial institution about payments to such account holders is made on Form 8966 "FATCA Report," which must be filed on or before March 31 following the year to which the Form relates.[71] A more detailed list of information that participating foreign financial institutions are likely to be required to report on Form 8966 is contained in Exhibit IX. No such filing is required by so-called "passive" foreign financial entities, their only Chapter 4 responsibility being to provide certain information about their "substantial" U.S. owners to withholding agents, which the withholding agents must in term report to the IRS on Form 8966.[72][73] However, it has now been decided that such entities should have an option to report

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[67] TR § 1.1471-4(c)(5)(i) (third sentence).

[68] TR § 1.1471-4(c)(5)(i) (fourth sentence).

[69] TR § 1.1471-4(d).

[70] TR § 1.1471-5(g).

[71] TR § 1.1471-4(d)(3)(vi).

[72] TR § 1.1474-1(i)(2).

[73] IRC § 1.1472(b); TR § 1.1472-1(b)(1)(iii)(3).

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information about their substantial U.S. owners directly to the IRS rather than to withholding agents. [74]

G. Compliance Certifications. The FATCA regulations make no distinction between foreign financial institutions with proven track records of compliance with documentary collection and review requirements under "anti-money laundering" and "know your customer" regimes and those without such experience: each institution is assumed to be working "from the ground up." Thus, the FATCA regulations are not content to impose the enhanced reporting obligations for filing Forms 8966, 1042 and 1042s annually with the IRS. In addition, the FATCA regulations require each institution to set up its own internal compliance system under the direction of a designated responsible officer "to oversee the participating FFI's compliance with the requirements of the FFI Agreement."[75] The responsible officer is required to certify to the IRS the financial institution's compliance with the diligence requirements for pre-existing accounts as well as confirm that it did not have in place from August 6, 2011 forward any formal or informal practices in place to assist account holders to avoid the requirements of Chapter 4.[76] The responsible officer is also required to make a triennial report regarding the maintenance and review of its compliance system as well as to report defaults and material failures in the institution's execution of its Chapter 4 responsibilities.[77]

H. Account Closures. In a paper like this that is trying to not "lose the forest for the ties," it may seem a distraction to call attention to the requirements of the FATCA Regulations requiring participating foreign financial institutions to close certain "non-cooperating accounts." But because this requirement may have been one of the major incentives for the United States to consider accepting modified FATCA regimes under the two forms of intergovernmental agreements, it deserves brief mention here. The FATCA regulations require a participating financial institution that cannot disclose information to the IRS about U.S. accounts and recalcitrant foreign accounts because of local law restrictions to obtain waivers of these restrictions, or such waivers failing (either because local law would make such a waiver

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[74] 2014 Temp. Reg., amending TR § 1.1472-1(c).

[75] TR § 1.1471-4(f)(2)(i).

[76] TR § 1.1471-4(c)(7).

[77] TR § 1.1471-4(f)(3).

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ineffective or because the account holder is unwilling to give a waiver), to close the account "within a reasonable period of time."[78] The requirement of closing uncooperative accounts also plays a large role in determining whether expanded affiliate groups can become FATCA-compliant in time to preserve the status of all members of the group as participating foreign financial institutions.[79] Consistent with the concept of giving more time to resolve issues of non-cooperation and local law impediments to FATCA disclosure, the intergovernmental agreements generally give partner countries and their financial institutions more time to resolve these issues.

IV. CHAPTER 4 REPORTING BY REPORTING FINANCIAL INSTITUTIONS UNDER INTERGOVERNMENTAL AGREEMENTS

The reporting requirements of non-U.S. financial institutions under FATCA-related inter-governmental agreements between the United States and other countries have many similarities with the requirements established for participating foreign financial institutions under the FATCA regulations but there is an altered focus – "reportable U.S. accounts" – and often a somewhat different balance of requirements to satisfactorily complete documentary due diligence. (A list of the information that each reporting Israel financial institution must report is contained in Exhibit X.) These arise most importantly because the focus of the inter-governmental agreements is almost exclusively on reporting rather than withholding, with the withholding requirements of Chapter 4 and the FATCA regulations being virtually swept away in favor of working out failures of cooperation by non-U.S. financial institutions and passive non-financial foreign entities almost exclusively on a government to government basis. There will likely be no withholding responsibility under the USA-Israel IGA with regard to recalcitrant account holders or payments to them;[80] the Chapter 4 withholding responsibility of Israel Qualified Intermediaries will likely be limited to withholding on payments to non-participating non-Israel foreign financial institutions.[81] Reporting obligations with regard to "nonparticipating financial institutions," under the USA-Israel intergovernmental agreement, will likely be limited

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[78] TR § 1.1471-4(a)(3).

[79] See TR § 1.1471-4(a)(4).

[80] See likely U.S. Israel IGA Article 4(2). Again it is important that exemption from the need to engage in Chapter 4 withholding does not excuse a financial institution from complying with any Chapter 3 withholding requirements to which it may be subject.

[81] See likely U.S.-Israel IGA, Article 4(1)(d).

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to required disclosures in 2015 and 2016,[82] and for this purpose most-non-participating Israel foreign financial institutions are likely to be excluded.[83] But reporting Israel financial institutions that are not qualified intermediaries, withholding partnerships or withholding trusts and that make payments to - or act as intermediaries with respect to withholdable payments to - any nonparticipating non-Israel foreign financial institution will most likely need to provide to the immediate payor of such payment "information required for withholding and reporting to occur with respect to such payment."[84]

The due diligence requirements under inter-governmental agreements, especially with regard to pre-existing accounts, seem to assume that financial institutions in the partner jurisdictions have already established a high level of documentation collection efficiency and accuracy under the partner jurisdiction's "anti-money laundering" regulations and "know your customer" requirements. Thus, especially in the area of pre-existing entity accounts, reporting financial institutions are not required to obtain certification from account holders using withholding certificates or their substantial equivalents as required under the FATCA regulations and instead are allowed to rely on information gathered from the data bases they have already developed and continue to maintain under local law requirements and regulations.

Under a Model I Intergovernmental Agreement, such as the USA-Israel Agreement, the bedrock concept of "participating financial institution" gives way to the concept of a "Reporting Financial Institution."[85] While "participating foreign financial institutions," from the U.S. perspective, are the "work horses" of FATCA, in so far as its reporting requirements are concerned, "Reporting Israel Financial Institutions" will be the "work horses" under the USA-Israel IGA in respect of accounts of U.S. persons held by Israel financial institutions because it is they that will be required to gather information about their account holders and investors that will meet the modified reporting tests of U.S. compliance under the IGA. The fact that this information is to be disclosed to the Israel tax authorities – for

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[82] See likely U.S. Israel IGA, Article 4(1)(b).

[83] See likely U.S. Israel IGA, Article 1(r).

[84] See likely U.S. Israel IGA, Article 4(1)(e)

[85] It should be remembered that Annex I of the Canadian Agreement is virtually identical to Annex I not only of the many other "Model I Agreements" the United States has signed with countries like the United Kingdom, Mexico and even the Cayman Islands but also the "Model 2" Agreements it has signed with Switzerland and Japan.

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transmission to the U.S. tax authorities[86] – rather than directly to the IRS does not change the fundamental FATCA tenet that non-U.S. financial entities and certain other types of offshore entities must make available to the IRS information that will enable it to ensure that taxes on foreign source income and derived from foreign property holdings abroad are being properly paid by U.S. taxpayers, that U.S. taxpayers are not enjoying the benefits of reduced rates of withholding tax intended for payments of U.S. source income to non-U.S. persons and, at least as an indirect consequence, that more reliable information is being used to determine Chapter 3 withholding on payments of U.S. source income to non-U.S. payors.

A. Pre-Existing Individual Accounts. Under Annex I of the USA-Israel IGA, the provisions for identifying U.S. reportable accounts of individuals will likely provide for essentially the same exceptions as the FATCA regulations themselves (pre-existing accounts that do not exceed $50,000, cash value insurance contracts and annuities held by individuals not exceeding $250,000 and "depositary accounts," regardless of when they were established, as long as their respective balances do not exceed $50,000).[87] The procedures for revising pre-existing individual accounts by review of a reporting institution's electronic searchable data records that do not exceed $1 million in value are likely to be essentially the same as those under the FATCA regulations, subject to application of very similar standards of review.[88] Enhanced review procedures that mirror the regulatory requirements will likely also be required for "high value" accounts or obligations exceeding $1 million in value.[89] However, unlike under the FATCA regulations, enhanced review may also likely be dispensed with if the Reporting Israel Financial Institution's electronically searchable information includes information about the account holder's nationality or residence status, residence and mailing address, telephone number, indications as to whether there are standing institutions to transfer funds to another

[86] See likely Article 2 of the U.S.-Israel IGA.

[87] Likely Annex I, Section I(B).

[88] Likely Annex I, Section II(B).

[89] Likely Annex I, Section I(B).

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account, whether there is a current "in use of" or "hold mail" address for the account holder, and whether any one has a power of attorney or signatory authority over the account.[90]

B. Pre-Existing Entity Accounts. As to pre-existing entity accounts, the same exclusion from documentation requirements under the FATCA regulations will likely apply under Annex I to the USA-Israel intergovernmental agreement for accounts that do not exceed $250,000 as of June 30, 2014 until the account balance value exceeds $1,000,000.[91] The focus of due diligence for pre-existing entity accounts will likely be accounts exceeding $1,000,000 in value held by one or more entities that are specified U.S. persons, passive non-foreign financial entities having one or more controlling persons who are U.S. citizens or residents, and, for 2015 and 2016, nonparticipating financial institutions to which payments have been made. Each reporting Israel financial institution will likely need to review information it maintains for regulatory or customer identification purposes, including "anti-money laundering" and "know your customer" purposes, to determine if the account holder is a U.S. person. If the information indicates U.S. ownership, the account will need to be treated as reportable to the United States unless the withholding agent receives a self-certification to the contrary from the account holder or has information allowing it to reasonably determine that the account holder is not a specified U.S. person.

Once having determined that the account holder is not a U.S. person, a reporting Israel institution will need to determine, based on its information data base as described in the foregoing paragraph, whether the account holder is a financial institution and, if so, whether the financial institution has a Global Intermediary Identification Number (based on the published IRS list), so as to enable the financial institution not to be treated as the holder of a U.S. reportable account.[92] If the above due diligence leads to the conclusion that an account holder is an Israel financial institution or a financial institution from another jurisdiction with which the United States has an intergovernmental agreement but that it does not have a GIIN, the reporting

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[90] Likely Annex I, Section I(D)(3). Certain due diligence procedures under Annex I regarding "lower value" and "high value" accounts are likely not to be required in the case of qualified intermediaries, withholding partnerships and withholding trusts who have already obtained documentation to establish an account holder's non-U.S. status or in the case of any financial institution that has agreed to follow the procedures of chapter 61 of the Internal Revenue Code as if it were a U.S. financial institution. Annex I, Section II(F).

[91] Likely Annex I, Section IV(A).

[92] Likely Annex I, Section IV(D).

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Israel institution will need to treat the account holder as a non-participating financial institution; if the account holder is determined to be a financial institution from a jurisdiction other than Israel or a jurisdiction with which the United States has an inter-governmental agreement, the institution will need to be considered a non-participating financial institution unless it self-certifies that it is a certified- deemed compliant FFI or an exempt beneficial owner.[93] Once a reporting Israel financial institution determines that the account holder is neither a U.S. person nor a financial institution, it will need to determine whether the account holder is a passive non-foreign financial entity with "controlling persons" and, if so, whether any such controlling persons are U.S. citizens or residents, using a combination of information it has collected for "anti-money laundering" and "know your customer" purposes and self-certifications.

C. New Individual Accounts. More striking differences will appear in the procedures for determining the U.S. reportable status of new account holders. The FATCA regulations give participating foreign financial institutions the option of relying on withholding statements or on certain objective forms of evidence such as government-issued tax certificates and other documentation and reports of certain third party credit agencies. The USA-Israel intergovernmental agreement, by contrast, will likely place primary reliance on an account holder's self-certification and a determination by the institution opening the account, based on its own due diligence using its "anti-money laundering" and "know your customer" procedures, that the information presented in the new account holder's self-certification is reliable for determining "whether the Account Holder is resident in the United States for tax purposes (a U.S. citizen for purposes of the test being deemed a U.S. resident even if the account holder is a resident of another jurisdiction)."[94] Once the financial institution has determined the account holder is a U.S. tax resident, the institution must obtain the account-holder's U.S. tax identification number.

D. New Entity Accounts. With regard to new entity accounts, the Reporting Israel institution must determine whether the account holder is a specified U.S. person, a Israel financial institution or a financial institution in another jurisdiction with which the United States has an inter-governmental agreement, a participating or deemed compliant foreign financial

[93] Likely Annex I, Section IV(D)(3).

[94] Likely Annex I, Section III(B)(1).

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institution, an exempt beneficial owner, or an active or passive non-foreign financial entity. A reporting Israel financial institution is allowed to determine if an account holder is an active non-foreign financial entity, an Israel financial institution or a financial institution in another jurisdiction with which the United States has entered into an inter-governmental agreement, based on the account holder's GIIN or other information available to it. In all other cases, the Reporting Israel institution must require the account holder to self-certify its FATCA status so that the Reporting Israel institution can determine if it is a U.S. reportable account.[95]

V. CHAPTER 4 WITHHOLDING FOR FOREIGN FINANCIAL INSTITUTIONS UNDER THE FATCA REGULATIONS

We now begin to deal with the topic of Chapter 4 withholding itself. Here, we must underscore the critical distinction between a "withholding agent" and a "participating foreign financial institution" – even if, in at least some instances, participating foreign financial institutions also serve as withholding agents. A withholding agent includes any individual or entity that has control over a U.S. source "withholdable payment" or "foreign pass-thru payment."[96] These withholding agents include U.S. individuals and entities as well as qualified intermediaries and any foreign individuals or institutions (including certain participating foreign financial institutions and registered deemed-compliant foreign financial institutions) that might be able to make a payment of U.S. source FDAP income or the gross proceeds of the sale of any asset that gives rise to FDAP income.[97] Parallel with the distinction between a withholding agent and a participating foreign financial institution is the equally key distinction between a "payee" and an "account holder." An account holder is generally the "person listed or identified as the holder or owner of the account" even if the owner is a partnership, trust, or a company acting as agent or intermediary for its depositors or investors.[98] A payee, unless the payee is a qualified intermediary, withholding partnership, withholding trust, certain non-U.S. non-financial entities or non-participating foreign financial institutions, however, is the person who ultimately receives the benefit of a financial payment such as a payment of interest or a dividend.[99] The chief due

[95] Likely Annex I, Section V.

[96] TR § 1.1473-1(d)(1).

[97] TR § 1.1473-1(d)(1).

[98] TR § 1.1471-5(a)(3).

[99] TR § 1.1471-3(a) *et seq*.

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diligence required of a participating foreign financial institution is to determine the tax status of its account holders. By contrast, the chief due diligence required of a withholding agent is to determine the tax status of the payees of payments it makes.

Contrary to popular impression, it is likely that a great number of foreign financial institutions complying with the FATCA regime will generally not have to engage in Chapter 4 withholding. This is true, first of all, because foreign financial jurisdictions in Model I IGA countries are generally exempt from having to engage in Chapter 4 withholding as long as the relevant countries carry out their IGA responsibilities and foreign financial institutions in Model II countries are also generally exempt from Chapter 4 withholding as long as they carry out their FATCA obligations as adjusted under the relevant intergovernmental agreement. In addition, foreign financial institutions that are neither qualified intermediaries nor withholding partnerships nor withholding trusts under the Chapter 3 withholding regime do not have primary Chapter 4 withholding responsibility; instead the FATCA regulations require that, wherever a withholding agent makes a payment of U.S. source FDAP income to a participating foreign financial institution or deemed-compliant foreign financial institution that is not a qualified intermediary and that receives the payment as an intermediary (such as a bank) or a non-withholding partnership or non-withholding trust, the payor withholding agent must withhold the Chapter 4 tax unless the participating foreign financial institution or deemed-compliant foreign financial institution provides the payor withholding agent with withholding certificates and statements meeting the requirements discussed above, which will enable the payor withholding agent to identify the portion of the payment allocable to recalcitrant account holders and nonparticipating foreign financial institutions and entities.[100]

The FATCA regulations seem to go even further in excusing any intermediary or flow-through entity from withholding if another withholding agent has withheld the full amount required and, perhaps even more significantly, by excusing a nonqualified intermediary, non-withholding partnership or non-withholding trust from withholding on a withholdable payment under Chapter 4 if it has provided such withholding agent with a valid intermediary withholding certificate or flow-through withholding certificate identifying any portion of such payment that

[100] TR § 1.1471-2(a)(2)(i).

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may be allocable to payees who are recalcitrant account holders or non-participating foreign financial institutions, and "it does not know and has no reason to know, that another withholding agent failed to withhold the correct amount."[101] The same effective exemption from withholding may also be enjoyed by qualified intermediaries that do not wish to engage in Chapter 4 withholding and instead elect to be "withheld upon" for Chapter 4 purposes (subject to their agreeing that they will not be able to engage in Chapter 3 withholding).[102]

Finally, it is also possible that some non-U.S. financial entities other than qualified intermediaries and flow-through entities (such as participating foreign financial institutions that trade for their own account) will have withholding responsibility with regard to so-called "foreign pass-thru payments" (essentially payments to foreign financial institutions organized as corporations with U.S. investors where the foreign financial institution receives payment of FDAP income or gross proceeds of FDAP-income generating assets for its own corporate investment activities but will later indirectly distribute some or all of this income or proceeds to its U.S. shareholders or owners) but this form of Chapter 4 withholding has been postponed until 2017 and it remains to be seen if this aspect of the FATCA legislation is even practicable.[103]

Thus, at least for now, the withholding responsibility of many participating foreign financial institutions and qualified intermediaries that elect to be withhold on, appears to be limited to "residual" situations where the institution or intermediary knows that the withholding agent charged with responsibility for the withholding has not properly withheld the Chapter 4 tax. Ironically, it appears that the main class of foreign financial institutions that

[101] TR § 1.1471-2(a)(2)(ii). Note that there seems to be an inconsistency here with regard to Chapter 4 gross proceeds withholding: Treasury Regulation 1.1471-2(a)(2)(i) requires withholding on payments of U.S. source FDAP income but does not impose an express delegation to withhold on payments of gross proceeds from the sale of assets generating FDAP income. But the language of TR 1.1471-2(a)(2)(ii) just quoted is unqualified and appears to confer an effective exemption from Chapter 4 withholding to participating foreign financial institutions and deemed-compliant institutions that are not qualified intermediaries, withholding partnerships and trusts, on all "withholdable payments" whether of income or proceeds as long as they engage in the required documentation for withholding tax purposes. The only withholding responsibility that such an institution or entity may have would arise if it had knowledge or reason to know that the correct withholding had not been conducted by the payor withholding agent.

[102] TR § 1.1471-2(a)(2)(iii). A qualified intermediary that does elect to serve as a primary withholding agent must first collect the Chapter 4 withholding tax, to the extent any is due before collecting Chapter 3 withholding tax. TR § 1.1471-6(b)(i).

[103] TR § 1.1471-4(b)(4).

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could be liable for withholding without reserve are nonparticipating foreign financial institutions if they should come into possession of withholdable payments because the definition of "withholding agent" under FATCA is "any person, U.S. or foreign, in whatever capacity acting, that has control, receipt, custody, disposal or payment of a withholdable payment or a foreign pass thru payment."[104] That Treasury considers that a nonparticipating foreign financial entity could have such a responsibility seems to be confirmed by the exclusion of any nonparticipating foreign financial institution "that is acting as a withholding agent with respect to one of its account holders" from the ability to apply for a refund or credit of an over-withholding of Chapter 4 tax where the tax was not withheld at the source but was later paid by the withholding agent to the IRS.[105]

But the actual effective exemption from Chapter 4 withholding conferred on what may well be the vast majority of foreign financial institutions comes at a price: non-withholding foreign financial institutions must, in addition to annually reporting information to the IRS about their U.S. account holders and recalcitrant account holders on Form 8966, also effectively "report" to the U.S. withholding agents, qualified intermediary withholding agents and other Chapter 4 withholding agents who directly or indirectly make payments to them or their account holders information about the payees of such payments who are U.S. persons, "recalcitrant account holders," and foreign financial institutions that do not elect to cooperate with the FATCA regime.[106] This means that each participating foreign financial institution that is an intermediary or pass-through entity but not a qualified intermediary, withholding partnership or withholding trust, will need to compile information from its account owners that are intermediaries (like banks) or flow through entities (like partnerships or trusts) about their own beneficial owners that will enable it to provide its withholding agents requisite information about recalcitrant account holders, non-compliant non-financial entities and non-participating foreign financial institutions. The principal method by which a foreign financial institution will collect this information from its intermediary or flow through account holders is Form W-8IMY (or a substitute form that contains all the relevant information reported on as a Form W-8IMY),

[104] TR § 1.1473-1(d)(1).

[105] TR § 1.1474-5(a)(1). See the discussion in Part VII below.

[106] TR § 1.1471-4(b)(3) (ii) referencing TR § 1.1471-3(c)(3)(iii).

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together with a withholding statement containing individual or pooled information about the beneficial owners of interests in each such intermediary or flow-through entity who are U.S. U.S. payees, recalcitrant account holders, and non-participating foreign financial institutions.[107]

Keep in mind that if a foreign financial entity is an intermediary (like a bank) or a flow-through entity (like a partnership), it may have depositors or partners who are themselves depositors or partners and that are therefore also intermediaries or flow-through entities. This pattern could repeat itself many times up a chain of intermediaries or flow-through entities until one arrives at the true payees or ultimate recipients of a withholdable payment. Under these circumstances, a responsible Chapter 4 withholding agent must obtain a withholding certificate (generally Form W-8IMY) from each intermediary or flow-through entity, a participating foreign financial institution should submit "an FFI withholding statement" that includes either payee specific information (when that is required for purposes of Chapter 3 or chapter 61 withholding) or pooled information indicating the portion of the payment allocable to U.S. persons, each class of recalcitrant account holders, and to nonparticipating FFIs.[108] In the case of a flow-through entity (but apparently not in the case of an intermediary entity), it appears the foreign flow through entity is permitted to provide withholding certificates to its withholding agent for each payee who is an owner of the entity in place of its own withholding certificate.[109]

As noted above, the FATCA statute and regulations also offer to qualified intermediaries the option not to engage in tax withholding but rather to elect "to be withheld on," placing them essentially in the same position as participating foreign financial institutions and deemed compliant foreign financial institutions that are not qualified intermediaries or withholding partnerships or trusts.[110] Of course, notwithstanding the somewhat clumsy statutory terminology about being "withheld upon," qualified intermediaries that make this election can actually not be withheld on – or can be withheld on only in respect of payments allocable to recalcitrant account holders and non-participating foreign financial institutions – as long as they

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[107] TR § 1.1471-3(c)(3)(iii)(B)(2). Note TR § 1.1471-3(c)(3)(iii)(A)(8), referencing TR § 1.1471-3(c)(iii)(B)(2).

[108] TR § 1.1471-3(c)(3)(iii)(B)(2).

[109] TR § 1.1471-3(c)(2)(i) (last sentence).

[110] IRC § 1.1471(b)(3), TR § 1.1471-2(a)(2)(iii)(A). Note that a qualified intermediary that makes an election to be withheld upon for purposes of Chapter 4 withholding cannot assume primary responsibility for Chapter 3 withholding.

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file an appropriate FFI withholding statement with the payor withholding agent providing the information the agent will need to determine to what extent, if any, Chapter 4 tax should be withheld on payment to such a qualified intermediary in the same manner required for payments to foreign financial institution that are not nonqualified intermediaries, withholding partnerships or withholding trusts. A qualified intermediary that does elect to serve as a primary withholding agent must credit the Chapter 4 withholding tax, to the extent any is due, against the Chapter 3 withholding tax.[111]

When dealing with the withholding requirements of FATCA, it is important to grasp the important distinction between "grandfathered obligations" and "pre-existing obligations" and not to confuse these with the categories of "pre-existing accounts" and "offshore obligations!" Pre-existing obligation is a very broad category and includes "any account, instrument, contract, debt or equity interest maintained, executed, or issued by a withholding agent that is outstanding on July 1, 2014.[112] Pre-existing obligations must not be confused with "pre-existing accounts": the latter concept primarily relates to information reporting rather than withholding. There are substantive differences, in respect of pre-existing individual accounts, in the documentation and due diligence required for accounts opened prior to July 1, 2014 and those opened on or after July 1, 2014. "Grandfathered obligations" are obligations outstanding on July 1, 2014 but the definition of an "obligation" under this category is restricted to a debt instrument, a fixed-term credit agreement, certain derivatives transactions, certain life insurance contracts, and certain annuity contracts that have a staled expiration or term and that are not treated as equity for U.S. tax purposes.[113] The difference between the two categories of obligation is important because "grandfathered obligations" are completely exempt from the Chapter 4 withholding tax[114] whereas the much more populous group of "pre-existing obligations" are subject to Chapter 4 withholding, absent proper FATCA compliance, beginning on July 1, 2014, subject to a two-year postponement until July 1, 2016 <u>unless</u> the payee has been documented to be a non-participating foreign financial entity or, with respect to such obligation,

[111] TR § 1.1474-6(b)(i).

[112] TR § 1.1471-1(b)(104).

[113] TR § 1.1471-2(b) *et seq*.

[114] TR § 1.1471-2(b)(1).

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qualifies as a "prima facie FFI."[115] If a payee is so identified by the withholding agent as a prima facie FFI and fails to take the steps to qualify as a participating financial institution or as a financial institution compliant with a relevant intergovernmental agreement, Chapter 4 withholding on payments to that payee must commence on January 1, 2015.[116] Finally, as discussed above, there are somewhat more liberalized documentation requirements for certain non-U.S. recipients of payments to a subsidiary or affiliate of a U.S. payor/withholding agent, which are defined as "offshore obligations."[117] Again, the significance of the category is more for documentation and information reporting than it is for withholding because offshore obligations are potentially subject to Chapter 4 withholding unless they are "grandfathered obligations."[118]

Each withholding agent under Chapter 4 is required to file an income tax return on Form 1042, "Annual Withholding Tax Return for U.S. Source Income of Foreign Persons" to report withholdable payments of FDAP income, and gross proceeds (but not before January 1, 2017), foreign pass-thru payments (not before January 1, 2017) and a payment of FDAP income that would be a withholdable payment if paid by a U.S. person.[119] Each such withholding agent must also file complementary Forms 1042-S ("Foreign Person's U.S. Source Income Subject to Withholding") to report such withholdable payments made to each recipient and provide a copy of such Form 1042-S to each such recipient.[120] Any foreign financial entity that is not a qualified intermediary, withholding partnership or withholding trust, as explained above, as long as it provides the payor withholding agent with the required information about the portions of any withholdable payment that should be allocated to recalcitrant account holders and nonparticipating financial entities, should generally (i.e., in the absence of any "residual" withholding responsibility) not be obligated to engage in Chapter 4 withholding and therefore not be required to file Form 1042-S or Form 1042. In addition, for each of 2015 and 2016, participating foreign financial institutions and registered deemed-compliant institutions that

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[115] TR § 1.1471-2(a)(4)(ii)(A).

[116] TR § 1471-2(a)(4)(ii)(B).

[117] TR § 1.1471-1(b)(88).

[118] See generally TR § 1.1471-3(d) *et seq*.

[119] TR § 1.1474-1(c)(i).

[120] TR § 1.1474-1(d)(i).

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make payments of "foreign reportable amounts" must report on Form 8966 (not Form 1042-S, as originally envisioned), on a payee-specific basis, the aggregate amount of all such amounts paid to a nonparticipating foreign financial institution.[121]

VI. CHAPTER 4 WITHHOLDING FOR FOREIGN FINANCIAL INSTITUTIONS UNDER THE INTERGOVERNMENTAL AGREEMENTS

The Chapter 4 withholding tax, under a Model 1 Intergovernmental Agreement, like that between the United States and Israel, will be effectively suspended as to Israel financial institutions that register on the IRS portal as Reporting Model 1 Foreign Financial Institutions; this exemption will also extend to Reporting Israel Financial Institutions that are qualified intermediaries, withholding partnerships or withholding trusts, as long as they withhold 30% of any U.S. source withholdable payment to any non-participating foreign financial institution.[122] The Chapter 4 tax will otherwise only be able to come into play after the United States has lodged a complaint with the Israel government about non-compliant Israel financial institutions and an eighteen month period thereafter to correct the noncompliance. In any event, no Reporting Israel Financial Institution is likely to be required to withhold tax on any payment to a foreign financial institution or a non-financial foreign entity with respect to a recalcitrant account holder as long as Israel fulfills its reporting obligations with regard to U.S. reportable accounts under likely Article 2 of the U.S.-Israel agreement, within the likely time requirements of Article 3 of the Agreement.[123]

As noted above, Reporting Model 1 Institutions are generally treated as registered deemed-compliant foreign financial institutions with the result that withholding agents may not withhold upon them for Chapter 4 purposes even if such institutions may have recalcitrant account holders or accounts held by non-participating foreign financial institutions. As a condition of not being subject to Chapter 4 withholding tax, however, Reporting Model 1 Institutions that are qualified intermediaries, withholding partnerships or withholding trusts are required to withhold Chapter 4 tax on payments to nonparticipating foreign financial institutions

[121] TR § 1.1471-4(d)(2)(ii)(F).

[122] Likely U.S.-Israel IGA Article 4(1)(d).

[123] Likely U.S.-Israel IGA Article 4(2).

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that are not resident in the IGA partner jurisdiction[124] and all Reporting Model 1 Institutions, regardless of QI status, are obliged to provide information on withholdable payments to the payors of payments to such non-participating foreign financial institutions,[125] but the withholding agent does not appear to have any obligation to impose Chapter 4 withholding tax if the information is not provided unless the United States has lodged a complaint with its partner government and a period of eighteen months has passed without satisfactory resolution of the non-compliance.[126]

The Chapter 4 withholding tax is also generally suspended in the case of Model 2 Intergovernmental Agreements with countries like Japan and Switzerland as to recalcitrant account holders but not with regard to nonparticipating foreign financial institutions. Under these arrangements, Reporting Model 2 Institutions, in addition to being obligated to provide to withholding agents information about their U.S. accounts, must provide in the aggregate information about payments to non-consenting U.S. accounts at their institutions. Armed with this information, the United States (but not any U.S. financial institution just acting on its own) may make "ongoing requests" to the local competent authority under the relevant Model 2 Agreement for the production of all the information that the Reporting Model 2 Institution would have to have disclosed, if it had obtained the consent of the account holder, subject to certain procedural requirements such as review by an administrative tribunal in the jurisdiction of the reporting institution.[127]

We cannot leave the topic of withholding under inter-governmental agreements, however, without noting that nothing in the FATCA regulations or the terms of any inter-governmental agreement excuse a reporting Model 1 or Model 2 institution from having to deliver a withholding certificate or other authorized documentation to any withholding agent making a payment to it. Failure to do so would most certainly generate a Chapter 4 tax on withholdable payments to the institution. The new Forms W-8BEN-E and W-8IMY provide for the possibility that Model 1 and Model 2 reporting institutions will be completing and delivering

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[124] Likely U.S.-Israel IGA, Article 4(1)(d).

[125] Likely U.S.-Israel IGA Article 4(1)(e).

[126] Likely U.S.-Israel IGA Article 4(1)(e).

[127] See U.S.-Switzerland IGA, Article 5.

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these forms. Completing a W-8BEN-E or W-8ECI does not appear to raise any particular additional compliance issues such as the need to produce the withholding statements required under the FATCA regulations of non-qualified intermediaries and nonwithholding trusts and partnerships where a Reporting Model 1 or Model 2 institution is not an intermediary. Completing a W-8IMY should not pose any particular compliance challenges for a Model 1 or Model 2 Reporting Institution that is also a qualified intermediary, withholding partnership or withholding trust, which has accepted Chapter 3 and Chapter 4 withholding responsibility because their current agreements under Chapter 3 will be modified to include their Chapter 4 obligations and, therefore, they generally should not need to complete any such withholding statements precisely because they have assumed primary withholding responsibility under Chapter 4 as well as Chapter 3.

However, the FATCA Regulations do not appear to be as clear concerning the responsibility of Model 1 reporting institutions that are non-qualified intermediaries, non-withholding partnerships and non-withholding trusts to produce withholding statements, even though they are exempt from Chapter 4 withholding and do not report any information directly to the IRS. The better view appears to be that they should not have to provide this information. This is based on the fact that the provisions of TR § 1.1471-3(c)(3)(iii)(A) and the related provisions of TR § 1.1471-3(c)(iii)(A)(8) and 1.1471-3(c)(iii)(B)(2) apply these requirements expressly to participating foreign financial institutions but not Reporting Model 1 or Model 2 Financial Institutions. ("Reporting Model 1 FFI" is a term under the FATCA Regulations that is defined separately from "participating FFI".)[128] Moreover, at least in the case of the USA-Israel Intergovernmental Agreement, Article 4(1)(e) will likely impose a specific requirement that a Reporting Israel Financial Institution provide to an immediate payor of a U.S. source withholdable payment information required for reporting and withholding on payments to nonparticipating foreign financial institutions not resident in Israel made by the Israel institution. That the Agreement should expressly require this form of reporting to a withholding agent (i.e., the immediate payor) and no other makes it unlikely that the parties to the Agreement would have intended that Reporting Israel Financial Institutions that are nonqualified intermediaries should have to collect and report to withholding agents information about recalcitrant account

[128] Compare TR § 1.1471-1(b)(107) with TR § 1.1471-1(b)(85).

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holders. While the likely provisions of Article 4(2) suspending the regulatory rules regarding recalcitrant account holders may not specifically address this issue, it appears to be within the spirit of that suspension that Reporting Israel Financial Institutions not be required to engage in such reporting as being forced to do so would appear to eliminate much of the advantage of the expected suspension under the U.S.-Israel Intergovernmental Agreement of the recalcitrant account holder provisions in the first place.

Finally, the FATCA regulations provide some limited relief in terms of the documentation a Reporting Model 1 foreign financial institution must provide to withholding agents for payments made prior to January 1, 2015. Thus, a withholding agent may treat a payee that is a foreign financial institution or a branch of a foreign financial institution as a Reporting Model 1 foreign financial institution if it receives a withholding certificate from the payee indicating it is a reporting Model 1 foreign financial institution and the country in which it is a Reporting Model 1 foreign financial institution, regardless of whether the certificate contains a GIIN for the payee.[129] In the case of payments made prior to January 1, 2015 with respect to pre-existing obligations, a withholding agent may treat a payee as a Reporting Model 1 foreign financial institution if it obtains a pre-FATCA Form W-8 from the payee, and the payee indicates orally or in writing that it is a Reporting Model 1 foreign financial institution and the country in which it is a Reporting Model 1 foreign financial institution, regardless of whether it has a GIIN.[130] For payments made prior to January 1, 2015, a withholding agent may treat a payee as a Reporting Model 1 foreign financial institution if the payee informs the withholding agent that it is a Reporting Model 1 foreign financial institution and provides the country in which it is a Reporting Model 1 foreign financial institution, but if the payment consists of U.S. source FDAP income, the payee must also provide a written statement that it is the beneficial owner of the payment and documentary evidence supporting the payee's claim of foreign status.[131]

VII. CHAPTER 4 WITHHOLDING REFUNDS AND CREDITS

In the rush and complexity of administering the Chapter 4 withholding tax, it should come as no surprise that monies sometimes will be over – or under – withheld. In the

[129] TR § 1.1471-3(d)(4)(iv)(A).

[130] TR § 1471-3(d)(4)(iv)(B).

[131] TR § 1.1471-3(d)(4)(iv)(C).

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cases of over-withholding, the FATCA regulations allow actions to right the imbalance. The key methods are “adjustments” and “set-offs”. In the case of an adjustment, reimbursement for over withheld tax can be realized through reduction of any tax deposit for any subsequent payment period before the end of the calendar year after the calendar year in which the over withholding took place.[132] To qualify for adjustment, the beneficial owner must be repaid before the earlier of the due date (no extensions) for filing Form 1042-S for year of over withholding or the date Form 1042-S is actually filed with IRS. This adjustment must be reflected on Form 1042-S and reporting must also be made on Form 1042 as well.[133] Another remedy for over withholding is set-off; this involves the effective repayment to an owner or payee of over withheld tax by applying the over withheld amount required to be withheld under Chapter 3 or 4 by the withholding agent to such person before the earlier of the due date (no extensions) for filing Form 1042-S for the year of over withholding or the date that form 1042-S is actually filed.[134]

The deadlines for effecting adjustments or set-offs are very tight. In the absence of meeting these requirements, relief must be sought by tax refund or credit. A refund or credit of tax is available to a beneficial owner of a payment where tax was withheld at source. In cases of withholding not at source but later paid by a withholding agent, a refund or credit can be made to the withholding agent to the extent the withholding agent provides adequate documentation to the IRS but in a case where a non-participating foreign financial institution withheld the tax, only the beneficial account holder of the FFI can apply for a credit or refund.[135] It is important to note that non-participating FFIs that are beneficial owners of payments subject to Chapter 4 withholding can receive a credit only to the extent allowed under any applicable treaty binding on the USA.[136] Refunding on payments to a non-financial foreign entity that is the beneficial owners of such payments is allowed only if the non-financial foreign entity on which tax was

[132] TR § 1.1474-2(a)(3).

[133] TR § 1.1474-2(a)(3)(i)(A)-(C).

[134] TR § 1.1474-2(a)(4).

[135] TR § 1.1474-5(a)(1).

[136] TR § 1.1474-5(a)(2).

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over-withheld files a U.S. income tax return containing information as to whether the entity has any substantial U.S. owners.[137]

Finally, there is also a collective credit or refund procedure made available to participating foreign financial institutions and Reporting Model 1 foreign financial institutions where Chapter 4 tax was over withheld and tax was not recovered under the refund or set-off procedures just described, perhaps because those steps could not be taken in time.[138] However, the collective refund procedure cannot be used to recover tax on payments to an account holder or payee that was a nonparticipating foreign financial institution, a participating foreign financial institutions or a Reporting Model 1 foreign financial institution that is a flow-through entity or that is acting as an intermediary, a U.S. person, or a passive non-financial foreign entity that is a flow-through entity, with respect to taxes allocated to its substantial U.S. owners. Explanations for why the set-off and refunding procedures described above were not used and other representations must be made in what appears to be a complex filing.[139]

[137] TR § 1.1474-5(a)(3).

[138] TR § 1.1471-4(h)(1).

[139] TR § 1.1471-4(h)(4).

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EXHIBIT I

LIST OF U.S. PERSONS NOT TREATED AS "SPECIFIED U.S. PERSONS[140]

1. Corporation whose stock is regularly traded on one or more established securities markets.

2. Corporation that is a member of the same expanded affiliated group as a corporation referred to in #1.

3. Organization exempt from taxation under Section 501(a) of the Internal Revenue Code or an individual retirement plan.

4. The United States or any wholly owned agency or instrumentality thereof.

5. Any State, the District of Columbia, any political subdivision or any wholly-owned agency or instrumentality thereof.

6. Any bank incorporated or doing business in the United States as defined in Section 581 of the Internal Revenue Code.

7. Any real estate investment trust as defined in Section 856 of the Internal Revenue Code.

8. Any regulated investment company as defined in Section 851 of the Internal Revenue Code or any entity registered with the U.S. under the Investment Company Act of 1940.

9. Any common trust fund as defined in Section 584(a) of the Internal Revenue Code.

10. Any trust exempt from tax under section 664(c) or described in Section 4947(a)(c) of the Internal Revenue Code.

11. Any dealer in securities, commodities, or derivative financial instruments that is registered under the laws of the United States or any States.

12, A broker.

13. Any tax exempt trust under a Section 403(b) or Section 457(g) plan.

[140] TR § 1.1473-1(c).

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EXHIBIT II

FOREIGN ENTITIES NOT SUBJECT TO CHAPTER 4 WITHHOLDING

A. Any foreign government, any political subdivision thereof or any wholly owned agency or instrumentality of any one or more of the foregoing.

B. Any international organization or any wholly owned agency or instrumentality thereof.

C. Foreign Central Bank of Issue.

D. Governments of U.S. Territories

E. Certain Retirement Funds.

1. Treaty-qualified retirement funds.
2. Broad participation retirement funds.
3. Narrow participation retirement funds.
4. Funds formed pursuant to a plan similar to a Section 401(a) plan.
5. Investment vehicles set up exclusivity for retirement funds.
6. Pension Fund of an exempt beneficial owner.

F. Entities wholly owned by exempt beneficial owners.[141]

G. Publicly traded foreign corporations that are not financial entities.

H. Certain affiliated entities related to a publicly traded corporation

I. Certain territory entities – wholly owned by one or more bona fide residents of the same U.S. Territory.

J. Active non-foreign financial entities.[142]

K. Entity member of non-financial group.

L. Holding companies.

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[141] TR § 1.1471-6(a) *et seq.* (Exempt Beneficial Owners) (to the extent such owners are not involved in commercial financial activities – see TR § 1.1471-6(h)).

[142] TR § 1.1472-1(c)(1) (Excepted Non-Financial Foreign Entities).

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M. Treasury centers.

N. Captive finance companies.

O. Non-financial start-up companies or companies entering a new line of business.

P. Non-financial entities in liquidation or bankruptcy.

Q. Excepted inter-affiliate FFI.

R. Section 501(c) entities.

S. Non-profit organizations.[143]

[143] TR § 1.1472-1(c)(1)(v), referencing TR § 1.1471-5(e)(5) (Excluded Entities).

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EXHIBIT III

GENERAL TYPES OF NON-REPORTING INSTITUTIONS UNDER ANNEX II OF A U.S. INTERGOVERNMENTAL AGREEMENT

I. Exempt beneficial Owners

A. Central Bank of partner jurisdiction.

B. Office of partner jurisdiction with an international organization listed under a relevant partner jurisdiction regulation or directive.

C. Retirement funds as specified under relevant provisions of the income tax treaty between the United States and the partner jurisdiction or other relevant source.

D. Investment entity owned by exempt beneficial owners.

II. Deemed-Compliant Financial Institutions

A. Financial Institution with a local client base.

B. Local bank.

C. Financial Institution with only low-value accounts.

D. Sponsored investment entity and controlled foreign corporation

E. Sponsored, closely held vehicle.

F. Restricted fund.

G. Other special Categories under the law of the relevant partner jurisdiction.

III. Excluded Financial Accounts such as tax preferred retirement and savings accounts under law of partner jurisdiction.

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EXHIBIT IV

DEEMED COMPLIANT FFIS[144]

A. Registered deemed compliant FFIs[145]

1. Reporting Model I FFIs
2. Reporting Model II FFIs
3. Local FFIs
4. Nonreporting members of participating FFI groups
5. Qualified collection investment vehicles
6. Restricted funds
7. Qualified credit (and Issuers)
8. Sponsored investment entities and controlled foreign corporations

B. Certified deemed-compliant FFIs[146]

1. Nonregistering local bank
2. FFIs with only low value accounts
3. Sponsored, closely held investment vehicles
4. Limited life debt investment entities

C. Owner-documented foreign financial organizations[147]

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[144] TR § 1.471-5(f).

[145] TR § 1.471-5(f)(1).

[146] TR § 1.471-5(f)(2).

[147] TR § 1.471-5(f)(3).

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EXHIBIT V

GENERAL RULES REGARDING DOCUMENTATION ON WHICH WITHHOLDING AGENTS MAY RELY[148]

A. Regulatory requirements for validity of withholding certificates, written statements and documentary evidence must be followed.

B. Forms of withholding certificates

1. W-9 for U.S. owners (not a U.S. branch of foreign persons treated as U.S. person or a foreign branch of a U.S. FI that is a QI).

2. W-8BEN-E for foreign beneficial owners.

3. W-8IMY for intermediary, flow-through entity, or U.S. branch of foreign person.

4. W-8EXP for exempt status.

5. W-8ECI for effectively-connected income.

C. Withholding statements: when withholding agent also needs a withholding statement for Chapter 3 as well as Chapter 4, information for Chapter 3 as well as information for Chapter 4 must be included.

D. Written statements: statements by payee or other person receiving payment providing information relevant to Chapter 4 status.

E. Documentary requirements to establish foreign status

1. Certificate of residence

2. Individual government identification

3. QI documentation

4. Entity government documentation

5. Third party credit report

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[148] TR § 1.1471-3(c) et seq. It should be noted that the FATCA regulations allow for some reliance on Forms W-8 obtained before FATCA compliance is required – generally July 1, 2014. Thus, to establish a payee's status as a foreign individual, foreign government, government of a U.S. territory or an international organization, a withholding agent may rely on a pre-FATCA Form W-8. In the case of other payees, a withholding agent may, for payments made before January 1, 2017, rely upon a pre-FATCA Form W-8 if the agent has one or more forms of documentary evidence listed under "F" in the above list and has obtained additional information relevant to the particular institution listed in Exhibit VI. TR § 1.1471-3(d)(1). It appears that these provisions should also apply to participating foreign financial institutions in documenting their account holders.

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F. Documentation supporting claim of Chapter 4 status

1. General documentary evidence (for entities other than PFFIs or registered deemed compliant FFs) including any organizational document such as articles of incorporation or a trust agreement, financial statement, third-party credit report, etc.

2. Pre-existing account documentary evidence includes standardized industry codes that was recorded by the withholding agent consistent with its normal business practices for AML purposes or other regulatory practices, as long as there are no U.S. indicia for which "curing" documentation has not been obtained

3. Payee-specific documentary evidence includes letter from auditor or attorney located in USA not related to withholding agent or payee and other third-party evidence

G. Documentation must be on account-by-account basis, with exception for

1. Single branch systems

2. Universal account systems

3. Shared account systems

H. Other sources

1. Documentation collected by or certifications provided by agent of withholding agent and third-party data providers

2. Certification by introducing brokers

3. Documentation provided between principals and agents

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EXHIBIT VI

PRIMARY FORMS OF DOCUMENTATION TO ENABLE PARTICIPATING FOREIGN FINANCIAL INSTITUTIONS AND WITHHOLDING AGENTS TO ESTABLISH CHAPTER 4 STATUS OF FOREIGN ENTITY ACCOUNT HOLDERS AND PAYEES[149]

1. Participating FFI: withholding certificate, GIIN[150]

2. Registered deemed compliant FFI: withholding certificate, GIIN.[151]

3. Certified deemed compliant FFI (other than sponsored FFI): withholding certificate with certification that payee meets requirements to qualify as relevant certified deemed compliant status, subject to additional requirements if certified deemed compliant FFI is a flow-through entity, acts as an intermediary, etc.

4. Sponsored, closely-held investment vehicles (registered deemed compliant): withholding certificate and sponsor's GIIN.

5. Investment Advisors or Managers that do not maintain financial accounts: withholding certificate.

6. Owner-documented FFI (certified deemed compliant):

   a. Withholding certificate identifying payee as owner documented and not an intermediary;

   b. Withholding agent is USFI, PFFI or Model 1 FFI that agrees to serve as a designated withholding agent for payee;

   c. FFI owner reporting statement;

   d. Valid documentation re each person identified on statement.

7. Nonreporting IGA FFI: withholding certificate.

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[149] TR § 1.1471-3(d).

[150] Pre-existing Obligations: Pre-FATCA Form W-8 and GIIN sufficient for payments before 1/1/17. In an apparent effort to make the Chapter 4 documentation requirements consistent with pre-FATCA requirements for reporting payments of FDAP income to foreign payees, the FATCA regulations appear to give participating foreign financial institutions and deemed compliant institutions an option, for payments to them of FDAP income by U.S. withholding agents of which they are the beneficial owners, of providing to the withholding agent a written statement containing the payee's GIIN, an affirmation that the payee is a participating FFI or deemed-compliant FFI, and documentary evidence supporting the institution's foreign status.

[151] Pre-existing Obligations: AML due diligence for payments before 1/1/17.

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8. Nonparticipating FFI:

a. Withholding certificate indicating that payee is beneficial owner and payee is not engaged in commercial financial activities;

b. International organizations: designation by Executive Order pursuant to 28 U.S.C. 288-288(f).

9. Retirement funds: withholding certificate[152]

10. Entities wholly owned by exempt beneficial owners:

a. Withholding certificate or written statement;

b. Owner reporting statement;

c. Documents re owners.

11. Territory financial institutions: withholding certificate or (when acting as intermediaries or flow-through entities), withholding certificate with statement that TFI agrees to be treated as U.S. person.[153]

12. Excepted NFFEs:

a. Withholding certificate

b. Written Statement (for offshore obligations).

c. Other Documentary Evidence

13. Excepted non-financial start-up companies: withholding certificate and formation date less than 24 months before payment.

14. Excepted NFFEs in liquidation or bankruptcy: Withholding certificate and payee has not claimed such status for more than three years.[154]

15. Section 501(c) organizations: withholding certificate and certification of qualification as 501(c) organization or opinion of U.S. counsel.

16. Non-profit organizations. withholding certificate.[155]

17. NFFE publicly-traded corporations, withholding certificate providing name of relevant securities exchange. [156]

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[152] Pre-existing Obligations: documentary evidence.

[153] Pre-existing Obligations: written statement and documentary evidence.

[154] Pre-existing Obligations: documentary evidence.

[155] Pre-existing Obligations: letter of counsel or letter from taxing authority.

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18. NFFE affiliates: withholding certificate providing name of entity that is regularly traded and name of relevant stock exchange.[157]

19. Excepted territory NFFEs: withholding certificate (including that all owners are U.S. bona fide residents of territory).[158]

20. Active NFFEs: withholding certificate.[159]

21. Direct Reporting NFFE: withholding certificate and GIIN.

22. Sponsored Direct Reporting NFFE: withholding certificate identifying sponsor's GIIN.

23. Excepted Inter Affiliate FFI: withholding certificate.

24. Passive NFFEs:[160]

a. Withholding certificate

b. Information about U.S. owners.

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[156] Pre-existing Obligations: documentation about public listing.

[157] Pre-existing Obligations: documentation of affiliations, NFFE status and claim of non-U.S. status.

[158] Pre-existing Obligations: $1 million or less: Pre-FATCA Form W-8, documentation and AML due diligence.

[159] Pre-existing Obligations: documentary evidence.

[160] Pre-existing Obligations: $1 million or less: AML due diligence.

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EXHIBIT VII

STANDARDS OF KNOWLEDGE ABOUT OFF-SHORE ACCOUNTS AND INVESTMENTS[161]

1. Requirements of honoring a notice by the IRS that reported information is incorrect within 30 days of such notice.

2. Requirement of not recognizing claim of PFFI or deemed compliant status if payee's name and GIIN do not appear on most recently published IRS FFI list within 90 days of claim of status.

3. Presumption that an FFI is a limited branch or limited FFI if payment is made to an address in a country other than the country indicated by the FFI.

4. Requirement of not recognizing claim of Model 1 Reporting status if there is no permanent residence address or no address of the relevant branch in the claimed IGA country or payment is being made to an address in country with which the United States has no IGA.

5. Requirement of not recognizing claim of Direct Reporting NFFE status or status as Sponsored Direct Reporting NFFE if GIIN does not appear on most recently published IRS PFFI lists within 90 days of claim of status.

6. General standard of reason to know "that a claim of Chapter 4 status is not reliable" if withholding agent's "knowledge of relevant facts or statements contained in the withholding certificates or other documentation is such that a reasonably prudent person in the position of the withholding agent would question the claims made." Generally, a withholding agent is considered to have reason to know that a claim of Chapter 4 status is incorrect if it is inconsistent with information contained in account opening files, customer account files, AML due diligence files.[162]

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[161]TR 1.1471-3(e).

[162] See TR § 1.1471-3(e)(4) for further guidelines.

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EXHIBIT VIII

PRESUMPTIONS OF STATUS OF OFFSHORE ACCOUNTS AND INVESTMENTS[163]

1. Generally, presume that person is individual or trust or an estate, if name or other indicia so indicate; alternatives are first corporations, than partnerships (see TR § 1.1441-1(b)(3)(ii)).

2. Presumptions of U.S. or foreign status based on TR § 1441-1(b)(3)(iii).

3. Presumption that a payee entity is a non-participating foreign financial institution in absence of valid withholding certificate or valid documentary evidence establishing entity's Chapter 4 status.

4. Presumption that payment to a foreign flow-through entity or intermediary is made to a nonparticipating foreign financial institution in absence of valid documentation or other authorized forms of communication.

5. Presumption that payments to certain U.S. branches of foreign banks and foreign insurance companies are payments of U.S. effectively-connected income.

6. Payments to unidentified individual joint payees presumed to be payment to a U.S. individual, but payments to unidentified entities presumed to be payments to non-participating foreign financial institutions.

[163]TR § 1.1471-3(f).

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EXHIBIT IX

REQUIRED REPORTING TO IRS ABOUT U.S. ACCOUNTS ON FORM 8966[164]

A. Reporting by participating FFIs generally

1. Name address, TIN of each account holder that is a specified U.S. person.

2. Account number

3. Account balance or value

4. Payments made during calendar year:

(a) Depositary accounts; aggregate gross amount of interest paid or credited to the account during the year;

(b) Custodial amounts; aggregate amount of dividends, interest, and all other income paid or credited to the account during the calendar year;

(c) Custodial accounts; gross proceeds from the sale or redemption of property paid to or credited to the account during the calendar year;

(d) Other accounts: payments made during the year that are gross amounts paid or credited with respect to debt, equity or cash value insurance.

5. Other information

B. Information about U.S. owned foreign entities (NFFEs)

1. Name of U.S. owned foreign entity that is account holder.

2. Name, address, TIN of each substantial U.S. owner of such entity.

3. Account number.

4. Account balance or value of account held by NFFE.

5. Payments made during calendar year.

(a) Depositary accounts; aggregate gross amount of interest paid or credited to the account during the year;

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[164] TR § 1.1471-4(d)(3).

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(b) Custodial amounts; aggregate amount of dividends, interest, and all other income paid or credited to the account during the calendar year;

(c) Custodial accounts; gross proceeds from the sale or redemption of property paid to or credited to the account during the calendar year;

(d) Other accounts: payments made during the year that are gross amounts paid or credited with respect to debt, equity or cash value insurance.

6. Other information

C. Reporting of Accounts held by Owner-documented FFIs.

1. Name of Owner documented FFI.

2. Name, address and TIN of each specified U.S. person that has an equity or debt interest in the FFI.

3. Account balance or value of account

4. Payments made with respect to the account during calendar year.

5. Other information.

D. Recalcitrant account holders ("RAHs")[165]

1. Aggregate number and value of accounts held by passive NFFE RAHs at end of calendar year.

2. Aggregate number and value of accounts held by U.S. person that are RAHs.

3. Aggregate number and value of accounts held by RAHs that are not passive NFFEs, U.S. persons or dormant accounts that have U.S. indicia.

4. Aggregate number and value of account held by RAHs that are not passive NFFEs or dormant accounts that do not have U.S. indicia.

5. Aggregate to number and balance of documents held by RAH that are dormant accounts.

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[165] TR § 1.1471-4(d)(6).

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E. Nonparticipating Foreign Financial Institutions (2015-2016)[166]

1. Name of Nonparticipating Foreign Financial Institution

2. Address.

3. Aggregate amount of payments to account.

[166] TR § 1.1471-4(d)(2)(ii)(F). There is also an option to report only the aggregate amount of payments to all nonparticipating foreign financial institutions if local law does not permit the names of disclosure of non-consenting institutions.

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EXHIBIT X

REQUIRED INFORMATION CONCERNING U.S. REPORTABLE ACCOUNTS UNDER MODEL 1 INTERGOVERNMENTAL AGREEMENTS[167]

1. Name, address and U.S. TIN of each Specified U.S. Person that is an account holder or a Controlling Person.

2. Account Number.

3. Name and identifying number of the Reporting Institution.

4. The account balance or value as of the end of the relevant calendar year or other appropriate reporting person.

5. In the case of any Custodial Account:

(a) Total gross amount of interest, dividends, other income paid or credited to the account during calendar year or appropriate reporting paid, and

(b) total gross proceeds from the sale or redemption of property paid or credited to the account with respect to which the Reporting Institutes acted as custodian, broker, nominee or otherwise as agent for the account holder.

6. In the case of any Depositary Account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period.

7. In the case of any other accounts, the total gross amount paid or credited to the account during the calendar year or other appropriate reporting period with respect to when the Reporting Institution is the obligor or debtor, including the amount of any redemption payments made to the account holder.

8. For any accounts owned by Nonparticipating Foreign Financial Institutions (as defined in the relevant Model 1 Agreement) in 2015 and 2016 only:

(a) Name of Nonparticipating Foreign Financial Institution.

(b) Aggregate amount of payments of such account.

[167] Under likely U.S. Israel IGA Article 3(3)&(4), Reporting Israel Financial Institutions, in 2014, will be required to report only items 1 through 4. In 2015 they likely will have to report all the items listed except for the gross proceeds described in item 5(b). Thereafter all items will likely have to be reported. Also, they will likely not be required to report the U.S. TIN of any relevant person with respect to an account opened as of June 30, 2014 if they do not have that information in their records, instead they will have to submit the birth date of such person if they have this information in their records.

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