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Tax Alert

New Guidance Outlines Phased Implementation of FATCA Beginning in 2013

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The Internal Revenue Service (IRS) has issued Notice 2011-53 (available **here**), which extends the time by which foreign financial institutions (FFIs) and withholding agents will be required to implement certain requirements of the Foreign Account Tax Compliance Act (FATCA) beyond the statutory effective date of January 1, 2013. For the reasons discussed below, FATCA guidance is important to investment managers, including managers of most offshore hedge funds, private equity funds and other alternative investment vehicles.

Among other extensions, under Notice 2011-53, withholding on U.S. source dividends and interest (and other types of passive income) paid to nonparticipating FFIs will not apply until January 1, 2014. Withholding on all “withholdable payments” (including on gross proceeds) will not apply until January 1, 2015.

Background

FATCA, which was enacted on March 18, 2010, is intended effectively to require FFIs to obtain, and, in some cases, provide to the IRS, certain information concerning their U.S.-taxpayer account holders and investors. Because, in many cases, the U.S. government may not have direct jurisdiction to require an FFI to comply with these rules, FATCA attempts to compel FFIs to do so by imposition of a punitive 30 percent withholding tax on “withholdable payments” made to an FFI, unless the FFI has entered into an FFI agreement with the IRS pursuant to which it contractually agrees to comply with certain administrative and reporting requirements. “Withholdable payments” are defined very broadly to include most forms of income from U.S. sources and gross proceeds from the sale or other disposition of property of a type that can produce U.S. source interest or dividends.

Prior to the release of Notice 2011-53, the IRS released Notice 2010-60 (available **here**) and Notice 2011-34 (available **here**). These notices provide preliminary guidance on various aspects of FATCA, including (i) the definition of an FFI; (ii) certain exceptions from the FATCA rules; (iii) due diligence procedures that an FFI (which has itself entered into an FFI agreement) will be required to follow in order to identify U.S. account holders; (iv) treatment of “passthru payments”; and (v) reporting of information with respect to U.S. accounts. For these purposes, most offshore hedge funds, private equity funds and other alternative investment vehicles will generally be FFIs and, if they enter into FFI agreements to avoid withholding, will be required to collect and report information regarding their investors.

Notice 2011-53

Notice 2011-53 acknowledges that compliance with FATCA may require financial institutions to make significant modifications to their recordkeeping procedures and accordingly phases in the implementation of FATCA as follows—

- The IRS will begin accepting electronic applications to enter into FFI agreements no later than January 1, 2013.

- An FFI must enter into an FFI agreement with the IRS by June 30, 2013, in order to be identified as a "participating FFI" in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014.

- The date on which an FFI agreement is deemed to be effective will establish the time period in which an FFI will have to satisfy due diligence procedures for identifying U.S. owners of accounts. For FFI agreements entered into no later than June 30, 2013, the effective date of any such agreement will be July 1, 2013. For FFI agreements entered into after June 30, 2013, the effective date will be the date on which the agreement is entered into.

- In general, the due diligence procedures for identifying U.S. owners of pre-existing accounts will have to be put in place within two years after the effective date of an FFI agreement. In the case of pre-existing private banking accounts, however, certain due diligence requirements may have to be satisfied earlier.

- Due diligence procedures for identifying U.S. owners of new accounts will have to be complied with for accounts opened on or after the effective date of an FFI agreement.

- Certain FFIs will be able to report, for the first year of implementation, more limited information than the reporting rules otherwise require.

- Withholding on U.S. source dividends and interest (and other types of passive income) paid to nonparticipating FFIs will begin on January 1, 2014. Withholding on all withholdable payments (including on gross proceeds) will be fully phased in on January 1, 2015.

Future Rulemaking and Guidance

The Treasury Department anticipates issuing proposed regulations incorporating the FATCA guidance, including Notice 2011-53, Notice 2011-34 and Notice 2010-60, by December 31, 2011, and anticipates publishing final regulations in the summer of 2012. Treasury and the IRS also anticipate issuing draft versions of the FFI agreements and reporting forms for use by withholding agents and participating FFIs in the summer of 2012.

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