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What a U.S. Company Needs to Know About FATCA, Foreign Account Tax Compliance Act.

As many of you may have heard or read about The Foreign Account Tax Compliance Act (FATCA) which was signed into law on March 18, 2010. This law imposes significant reporting, documentation and withholding obligations, and is not limited to financial institutions as the regulations impose significant and burdensome requirements on U.S. companies as well. Below is a summary of what a U.S. company should know in order to ensure their compliance with FATCA.

Generally, FATCA is aimed at preventing U.S. citizens and residents from avoiding U.S. tax through the use of offshore financial accounts. Under these provisions, a foreign financial institution ("FFI") may enter into an agreement with the Internal Revenue Service, under which the FFI would have certain reporting obligations, including providing information on the FFI's U.S.-held accounts. A financial institution can be an entity that accepts deposits in the ordinary course of a banking or similar business, an entity with a substantial portion of its business holding financial assets for the account of others, or an entity that is engaged in primarily in the business of investing, reinvesting, or trading the securities, partnership interests, commodities, or any interest in such securities, partnership interests, or commodities.

An FFI that enters into such an agreement becomes a "participating FFI," while an FFI that does not enter into an agreement with the IRS will become a "nonparticipating FFI" that is subject to 30% U.S. withholding tax on all "withholdable payments" from U.S. sources. The term "withholdable payment" means any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income, if such payment is from sources with the United States, and any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States.

The registration, due diligence, information reporting and withholding obligations under FATCA are generally effective as of January 1, 2014. Entities will have to determine by October 2013 whether they qualify as FFIs and to the extent they do, they need to register with the IRS.

Although most of the discussion related to FATCA's implications on U.S. payors of U.S. source withholdable payments has been focused on financial institutions, there is a certain procedure that needs to be complied with when a U.S. company makes a withholdable payment to a foreign entity that is not an FFI.

The general rule is the following: U.S. companies making withholdable payments to foreign entities have to withhold 30 percent under the FATCA rules unless the entities make certain disclosures to the IRS and/or to the U.S. withholding agent payor. The term "withholding agent" means all persons, in whatever capacity acting, having the control, receipt, custody, disposal or payment of any withholdable payment. In most cases, the U.S. company making the withholdable payment would be the withholding agent.

For purposes of complying with the FATCA rules, U.S. companies are expected to implement certain procedures that may require changes to previously used account payable systems and compliance processes.

The following are what a U.S. company should do when they are ready to make a payment to a foreign entity.

Firstly, the U.S. company should make a determination as to which of the payments it makes is a "withholdable payment" for purposes of FATCA. Please note, if the withholdable payment is for income effectively connected to a U.S. trade or business conducted by the foreign entity (e.g. fees for certain services), such payment is not subject to withholding under FATCA.

Secondly, the U.S. company should determine whether the foreign recipient of the withholdable payment is a foreign financial institution ("FFI") or a non-financial foreign entity ("NFFE"). Generally NFFEs that are publicly traded (including their subsidiaries) are not subject to FATCA. Also, NFFEs that conduct an actual business activity other than holding assets that provide investment income such as interest, dividends, rents, etc., (active NFFEs) are not subject to FATCA either. These publicly traded NFFEs and active NFFEs are collectively termed "excepted NFFEs." FFIs and those NFFEs that are not excepted NFFEs (the passive NFFEs), however, must either comply with certain disclosure rules or be subject to the 30 percent withholding tax.

Next, to the extent the income recipient identified above is an FFI, an inquiry must be made to determine whether the FFI is a participating FFI or a non-participating FFI. Non-participating FFIs will be subject to the 30% withholding.

Lastly, for NFFE recipients that are not excepted NFFEs, information should be requested and reported regarding any substantial U.S. owners. A substantial U.S. owner could be, if the NFFE is a corporation, a specified U.S. person which owns, directly or indirectly, more than 10% of the stock of such corporation, or if the NFFE is a partnership, a specified U.S. person who owns more than 10% of the profits interest or capital interests in such partnership. If such information is not provided, the payment should be subject to the 30% withholding tax.

The IRS published a draft of Form W-8BEN-E, Certificate of Status of Beneficial Owner for United States Tax Withholding (Entities). (<http://www.irs.gov/pub/irs-utl/formw8benentityexeccirculation2.pdf>.) Based on this form, the U.S. company should be able to tell whether the foreign entity is a participating FFI, a nonparticipating FFI, an excepted NFFE, or a passive NFFE. However, because this is just a draft, it is for your reference only.

Please note, the above is just a very general discussion. It is strongly recommended that a U.S. company should consider building out a compliance processes to ensure that all necessary determinations, monitoring, documentation and reporting is in place for purposes of complying with the FATCA rules.

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We hope this information is helpful. If you would like more details about these provisions or any other aspect of the new law, please do not hesitate to call us at (562) 463-3818.

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