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Latest FATCA Reporting and Withholding Developments for 2013

Navigating Complex Requirements for Reporting Foreign Assets

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FATCA Reporting and Withholding Requirements

Tuesday, November 6, 2012
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Introduction

- I. Foreign Account Tax Compliance Act (FATCA) overview
- II. FATCA information reporting
 - Section 6038D
 - T.D. 9567
 - Form 8938 and instructions
- III. FATCA withholding, reporting requirements
 - Sections 1471-1474
 - Proposed Regs issued February 8, 2012
 - Intergovernmental agreements
 - Effective dates

FATCA OVERVIEW

Foreign Account Tax Compliance Act (FATCA)

- March 18, 2010 - Hiring Incentives to Restore Employment Act (HIRE Act).
- Enacted Foreign Account Tax Compliance Act (FATCA) as an element of the HIRE Act.
- FATCA greatly increases disclosure requirements and penalties on taxpayers with foreign accounts and assets.
- FATCA reporting is in addition to the FBAR requirements.
- FATCA also imposes new withholding regime (in addition to existing withholding rules).
- New rules for U.S. payors.
- New burdens on foreign financial institutions (FFI) and non-financial foreign entities (NFFE).

FATCA INFORMATION REPORTING



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In General

- Section 6038D.
- Expanded reporting obligations for U.S. individuals with respect to any “specified foreign financial assets” with aggregate value exceeding \$50,000.
 - Reporting for “specified domestic entities” to come.
- Specified foreign financial assets (SFFAs) include:
 - Any financial account maintained by a foreign financial institution.
 - The following if not held in a financial account:
 - Any stock or security issued by a non-U.S. person.
 - Any interest in a foreign entity.
 - Any financial instrument or contract held for investment that has a non-U.S. issuer or counter-party.

Specified Foreign Financial Assets

- SFFA reporting much broader than FBAR reporting
 - Investments in foreign hedge funds, private equity funds and real estate owned by an entity.
 - Capital or profits interest in foreign partnership.
 - Notes, bonds, other indebtedness issued by foreign person.
 - Interest in a foreign trust or estate.
 - Interest in foreign pension or deferred compensation plan.
 - Swaps, options, derivatives, etc., with a foreign counterparty.
 - Not foreign real estate, but ...
 - Not gold in the vault, but ...
- Narrower, however, in that “interest” requires beneficial ownership.
- Interest in social security, social insurance or similar program sponsored by a foreign governments is not an SFFA.
 - Note: exception not in regs, and not defined. Caution!

Source of Rules

- Regulatory Framework:
 - Temp. Regs., 1.6038D-1T through -8T (excluding -5T).
 - T.D. 9567 (76 F.R. 243, 78553 (Dec 19 2011)).
 - Prop. Regs., 1.6038D-5T (and incorporate Temp Regs by reference)
 - REG-130302-10 (76 F.R. 243, 78594 (Dec 19 2011)).
- Form 8938 and Instructions (November 2011).

Interest in SFFA

- File Form 8938 if taxpayer has an “interest” in the SFFA.
 - Taxpayer has interest in SFFA if any income, gains, losses, deductions, credits, gross proceeds or distributions from the asset would be required to be reported on income tax return.
 - “Convenience owner”?
 - Taxpayer has interest in SFFA owned by disregarded entity or grantor trust.
 - Jointly owned assets:
 - Married taxpayers
 - Joint income tax returns - spouses report SFFAs only once.
 - Separate income tax returns - each spouse must report 100% of SFFAs.
 - Unmarried taxpayers - each joint owner must report 100% of SFFAs.

Valuation of SFFA

-
- Use value as of December 31 unless that does not reflect reasonable estimate of maximum value during the year.
 - Rely on periodic account statements unless reason to know that the statements do not reflect reasonable estimate of maximum value.
 - Valuation of non-public investments.
 - No appraisal required - “reasonable estimate”.
 - Presumption of aggregate value.
 - Convert foreign currency using FMS rate as of 12/31.
 - Assets with negative value reported at \$0.
 - Beneficiary of foreign trust reports value of all distributions made during the year plus value (using 7520 tables) of right to receive mandatory distributions as of the last day of the tax year.
 - Foreign estates, pension and deferred compensation plans are valued based on the fair market value of the interest in the assets. If unknown, report the value of all distributions made over the year.

Reporting Thresholds

- Living in the U.S.
 - Unmarried/separate - more than \$50,000 on 12/31 or \$75,000 at any time during the year.
 - Married/joint - more than \$100,000 on 12/31 or \$150,000 at any time during the year.
- Living abroad, as defined
 - Unmarried/separate - more than \$200,000 on 12/31 or \$300,000 at any time during the year.
 - Married/joint - more than \$400,000 on 12/31 or \$600,000 at any time.
- “Living abroad” means having a tax home in a foreign country and being a bona fide resident of foreign country/countries for entire year or at least 330 full days during any 12 consecutive months ending in that tax year.

Real Exceptions to Reporting

- Account/assets maintained by U.S. payor under Reg. 1.6049-5(c)(5)(i).
 - Includes U.S. branch of foreign bank.
- Account/assets of dealer or trader if subject to mark-to-market under Section 475(a) or Section 475(e) or (f) election.
- SFFAs held by domestic widely-held fixed investment trust.
- SFFAs held by domestic liquidating trust (Reg. 301-7701-4(d)) created under Bankruptcy Code (Chapt. 7 or 11).
- Bona fide resident of U.S. possession generally need not report SFFAs issued or maintained by organizations in that possession.

Fake Exceptions to Reporting

- So-called exception for duplicative reporting
 - Do not fully report assets that are reported on Forms 3520, 5471, 8621, 8865 or 8891.
 - However, specified individual must still file and check box on Part IV, assuming aggregate SFFAs exceed threshold
 - No instance in which duplicative reporting “exception” relieves specified individual of obligation to file Form 8938.
 - Quiz: when does 8891 = 3520??
- Similar so-called exception for foreign grantor trust.
 - Owner of foreign grantor trust does not report trust's SFFAs separately if owner files Form 3520 and Form 3520-A filed for the trust.
 - See above

Information Provided on Form 8938

- Basic identification of the account/asset.
- Name/address of financial institution where account is held (if applicable).
- Name/address of issuer or counterparty of stock, securities or financial instruments (if applicable).
- Information regarding whether account/asset was acquired (opened) or disposed of (closed) during the year.
 - Note the relevance for enforcement re: prior years!
- The amount of income, gain etc. recognized during the year and schedule, form or return on which reported to IRS.
- Currency exchange rate (and source of rate, if not FMS).
- If SFFA reported on other form (3520, 5471, etc.) report type and number of such other forms.

Specified Domestic Entities (SDEs)

- 6038D(f): “To the extent provided by the Secretary in regulations or other guidance, the provisions of this section shall apply to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if such entity were an individual.”
- Proposed regulations issued on December 14, 2011 provide for reporting by SDEs commencing for taxable years beginning after December 31, 2011.
 - See Prop. Reg. 1.6038D-6 (Specified domestic entities).
 - Applicability for 2012 presently uncertain
- SDE includes certain domestic corporations, partnerships or trusts.
- Estates are not SDEs.
- SDE qualification is tested annually.

SDEs; Corporations and Partnerships

- Domestic corporations and partnerships:
 - Have interest in SFFAs with aggregate value in excess of \$50,000.
 - Closely held by specified individual.
 - Individual owns at least 80% of stock (by vote or value) or capital or profits interest, as of the last day of SDE's taxable year.
 - Direct, indirect and constructive ownership rules apply.
 - One of the following two conditions is satisfied:
 - At least 50% of gross income is passive, or at least 50% of assets are held for the production of passive income; or
 - At least 10% of gross income is passive, or at least 10% of assets are held for the production of passive income, and the SDE was formed with the principal purpose of avoiding reporting under Section 6038D.
 - Valuation?

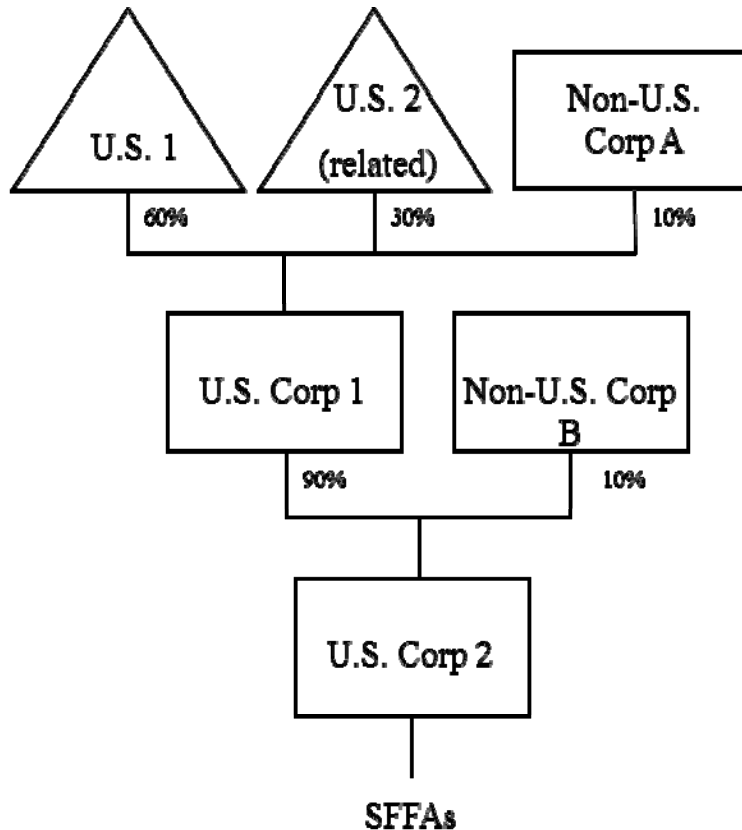
SDEs; Corporations and Partnerships (cont'd)

- Passive income includes dividends, interest, rents, royalties, annuities, capital gains, income from investments contracts.
 - Rents and royalties not included to extent derived in active trade or business.
 - No similar exception for dividends/interest.
- Capital gains included only when related to sale or exchange of passive assets.
- Futures, forwards and similar contracts not included if “commodity hedging transactions” under Section 954(c)(5)(A) (generally relating to hedging risk of price or currency fluctuations with respect to business property).

SDEs; Corporations and Partnerships (cont'd 2)

- Aggregation rules:
 - To determine whether the SDE meets the reporting threshold, all domestic corporations and partnerships owned by the same specified individual are treated as a single entity.
 - To determine whether the SDE meets the passive income or asset threshold, domestic corporations and partnerships that are closely held by the same individual and connected through ownership with a common parent entity are treated as a single entity.
 - Blessing and a curse.
- Constructive ownership:
 - Apply Section 267(c) and (e)(3), except that Section 267(c)(4) is expanded to include spouses of family members.

SDEs; Constructive Ownership



“Constructive Ownership” example:

U.S. 1 and U.S. 2 are related. Neither own interest (direct, indirect or constructive) in Non-U.S. Corp A or Non-U.S. Corp. B.

U.S. 1 owns 60% of U.S. Corp 1, and indirectly, 54% of U.S. Corp 2.

Including constructive ownership, U.S. 1 is deemed to own 90% of U.S. Corp 1 and, indirectly, 81% of U.S. Corp 2.

80% control threshold is satisfied, so U.S. Corp 2 is an SDE of U.S. 1, and would file Form 8938 to report its SFFAs.

See Prop.Reg. 1.6038D-6(b)(3)(iv).

SDEs; Domestic Trusts

- Domestic trusts is an SDE if
 - Has interest in SFFAs with aggregate value in excess of \$50,000.
 - One or more specified persons is a “current beneficiary” .
 - Current beneficiary is any person who may (whether by entitlement or exercise of discretion) receive a distribution from principal or income from the trust.
 - Without regard to powers of appointment that remain unexercised as of the end of the taxable year.

SDEs; Exceptions

- Domestic entity is not SDE if it is described in Section 1473(3) as excepted from definition of specified United States person:
 - Company traded on exchange or affiliate.
 - Organization exempt under Section 501(a) or IRA.
 - U.S., state, subdivision, agency, etc.
 - Bank, REIT, RIC, etc.
 - Common trust fund for bank's custodial/fiduciary funds under Section 584.
 - Although included under Section 1473(3), this exception does not apply to trust that is exempt from tax under Section 664(c), i.e., charitable remainder annuity trust or a charitable remainder unitrust.
- Domestic trust is not SDE if trustee is bank, financial institution or certain corporations subject to financial oversight, if the trustee timely files annual returns and informational returns for the trust.
- Grantor trust under Sections 671-679 is not an SDE.
 - The “grantor” may need to file Form 8938 directly, if applicable.

Form 8938; Penalties

- Penalties for failure to file or failure to report an asset:
 - \$10,000 minimum, increased for noncompliance 90 days after IRS notice up to \$50,000 maximum.
 - No stacking - See Temp. Reg. 1.6038D-8T(a).
 - Penalties joint and several for joint filers.
- Reasonable cause exception may apply, but you must “affirmatively show the facts that support a reasonable cause claim.”
- Section 6662 penalties increased from 20% up to 40% for underpayments involving undisclosed SFFAs. Section 6662(j).

Form 8938; Statute of Limitations

- Statute of limitations remains open until 3 years after all information is received.
- Six year statute of limitations if matter involves omission of gross income more than \$5,000 related to foreign financial asset.
 - Does not require substantial understatement.
- New statute of limitations applies to open years as of March 18, 2010.

FATCA WITHHOLDING

CURRENT WITHHOLDING REGIME

Background: Current (Old) WHT Regime

- Current withholding rules generally found in Chapter 3, Sections 1441-1464.
- 30% withholding on most U.S.-source FDAP paid to non-U.S. persons.
 - Several exemptions, including portfolio interest.
- Treaty exemptions & reduced rates.
- No withholding on gross proceeds.
- Foreign corporation provides Form W-8BEN, whether or not has U.S. owners.
 - Form 1042, 1042-S reports payments.
 - Excess withholding refunded.
- No withholding on U.S. persons, unless backup withholding applies.

Background: UBS, LGT Scandals

- Highlighted weaknesses of regular withholding tax rules (and QI rules).
- Designed primarily to assure that 30% withholding on payments of U.S.-source FDAP to foreign persons would be collected.
- Not designed particularly well to assure collection of proper tax and information reporting on income earned by U.S. persons through foreign accounts.

Background: Current QI Regime / Limited 1099 Reporting Rules

- Non-U.S. financial institution QI agreement:
 - QI must withhold or provide withholding “pool” information to withholding agent, so that withholding agent can withhold.
 - QI need not disclose foreign account holders.
 - External audit to ensure compliance.
- Theoretically, QIs file 1099s for U.S. customers, but:
 - Not required if U.S. customers have no U.S. securities.
 - Not required for foreign corporations with U.S. owners. I.e., no look-through.

NEW FATCA WITHHOLDING REGIME

FATCA Overview

- New Chapter 4, Sections 1471 - 1474. Withholding at 30% with respect to “withholdable payments” (“WPs”) in two categories of transactions:
 - Any WP to a “foreign financial institution” (“FFI”) unless (i) the FFI enters into an information-sharing and withholding agreement with the IRS, (ii) the FFI takes measures to ensure it does not have any U.S. customers, or (iii) certain other exceptions apply. [Section 1471(a)(1)]
 - Any WP to a “non-financial foreign entity” (“NFFE”) unless (i) the NFFE certifies that it does not have any substantial U.S. owners, (ii) the NFFE provides the name, address and TIN of all substantial U.S. owners, and the withholding agent reports this information to the IRS, or (iii) certain other exceptions apply. [Section 1472(a)-(b)]
- Withholding under FATCA must be made regardless of whether the payment is otherwise exempt from withholding under the Code.
- FATCA withholding is credited to tax account of beneficial owner and generally may be refunded if overpayment; but, certain limitations on refunds for FFIs.

FATCA Overview (cont'd)

- Although focus of FATCA is FFIs, other stakeholders have considerable interest:
 - NFFEs risk withholding and have compliance burdens
 - Withholding agents are responsible for withholding and reporting transactions
 - U.S. persons with foreign interests may otherwise be impacted
- Originally effective for payments after Dec 31 2012, proposed regulations would generally delay effective date until Jan 1, 2014 and then phase-in FATCA obligations.
- Discussion based on proposed regulations. Discussion does not cover procedural aspects of FATCA.

Certain Key Terms

- **Withholdable Payment (WP)** means any payment of:
 - interest (including original issue discount), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical (“FDAP”) income from U.S. sources. [Section 1473(1)(A)(i)]
 - Any gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from U.S. sources. [Section 1473(1)(A)(ii)]
- WP does not include income that is effectively connected with a U.S. trade or business (“ECI”). [Section 1473(1)(B)]
- Does not include payment of foreign source income.
- Does not include payment made under a “grandfathered obligation” (i.e., obligation outstanding on Jan 1, 2013).

Certain Key Terms (cont'd)

- **Foreign Financial Institution (FFI)** means any entity organized outside of the U.S. that:
 - accepts deposits from customers in the ordinary course of a banking or similar business,
 - as a substantial portion of its business, holds financial assets for the account of others,
 - is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, or any interest (including futures, forwards, and options) in such securities, partnerships, or commodities, or
 - is an insurance company (or holding company of an insurance company) that issues or is obligated to make payments with respect to a financial account (which includes cash value insurance contracts and annuities).

[Sections 1471(d)(5), (4); and 1473(5); Prop. Reg. 1.1471-5(e)]

- **Non-Financial Foreign Entity (NFFE)** means any foreign entity that is not an FFI. [Section 1472(d)]

FATCA FOR FFIs

FATCA For FFIs

- FATCA withholding on all WPs paid to an FFI, regardless of whether the FFI receives the WP as a beneficiary or an intermediary, unless, among other things:
 - Payee is a “participating FFI” [Prop. Reg. 1.1471-2(a)(4)(iii)]
 - Payee is a “deemed-compliant FFI” [Prop. Reg. 1.1471-2(a)(4)(iv)]
 - WP is allocable to “exempt beneficial owner” [Prop. Reg. 1.1471-2(a)(4)(v)]
 - Payee is an “excepted FFI” [Prop. Reg. 1.1471-1(b)(18); 1.1471-5(e)(5)]
 - Payee is an FFI that is deemed to comply with FATCA pursuant to an “intergovernmental agreement” to implement FATCA [Technically “deemed-compliant” per Prop. Reg. 1.1471-5(f)(1)]

FATCA For FFIs (cont'd)

- **Participating FFI** means an FFI that enters into an agreement with the IRS to:
 - Obtain information regarding holders of financial accounts to identify the U.S. accounts.
 - Comply with verification and due diligence procedures regarding identification of U.S. accounts.
 - Report information regarding U.S. accounts to the IRS, including name, address and TIN of each account holder that is a “specified U.S. person,” account number, balance, and income.
 - Deduct and withhold tax at 30% on “passthru payments” to recalcitrant account holders and non-participating FFIs, and on passthru payments to electing FFIs.
 - Request waivers of foreign law that would prevent reporting and, if not granted, close the account.
 - Comply with IRS requests for additional information regarding U.S. accounts.

[Section 1471(b)-(c)]

FATCA For FFIs (cont'd 2)

- Deemed-Compliant FFI includes an FFI that is:
 - A “registered deemed-compliant FFI,” which includes, for example, (i) a “local FFI,” i.e., licensed in its home country, subject to tax reporting obligations in its home country, no outside place of business, does not solicit customers outside, at least 98% of accounts are owned by residents of its home country, implements policies to avoid opening accounts for US persons that are not residents of its home country; (ii) a “restricted fund,” i.e., a regulated investment fund that prohibits investments by U.S. persons, nonparticipating FFIs or passive NFFEs with substantial U.S. owners; and (iii) an FFI deemed to comply pursuant to an intergovernmental agreement. [See Prop. Reg. 1.1471-5(f)(1)]

FATCA For FFIs (cont'd 3)

-Deemed-Compliant FFI also includes an FFI that is:
 - A “certified deemed-compliant FFI,” which includes, for example, (i) a “nonregistering local bank,” i.e., operating solely as a bank in its home country, subject to tax reporting obligations in its home country, no outside place of business, does not solicit customers outside, no more than \$175 million assets (or \$500 million as group); (ii) “retirement funds,” i.e., tax preferred retirement plan in home country where no single beneficiary has more than 5% of assets, or tax preferred retirement plan with less than 20 participants where not more than 20% of participants are nonresidents of home country and no nonresident is entitled to more than \$250,000; (iii) “non-profit organizations,” i.e., organized for religious, charitable, scientific purposes, exempt from tax in home country, no income or assets benefit private persons. [See Prop. Reg. 1.1471-5(f)(2)]

FATCA For FFIs (cont'd 4)

-Deemed-Compliant FFI also includes an FFI that is:
 - An “owner-documented FFI,” which is deemed-compliant only with respect to payments received by and accounts held with designated withholding agents. In short, this is an FFI that is not a bank, brokerage or insurance company, and is not affiliated with the foregoing, does not maintain accounts for nonparticipating FFIs, does not issue debt constituting a financial account in excess of \$50,000, and provides information to a designated withholding agent that agrees to report to the IRS with respect to owner-documented FFI’s direct or indirect owners that are specified U.S. persons. [See Prop. Reg. 1.1471-5(f)(3)]

FATCA For FFIs (cont'd 5)

- Exempt Beneficial Owner includes:
 - Foreign governments, political subdivisions, agencies and controlled entities
 - International organizations
 - Foreign central banks
 - Governments of U.S. possessions
 - Certain retirement funds
 - Entities wholly-owned by the foregoing

[See Prop. Reg. 1.1471-1(b)(19); 1.1471-6(b)-(g)]

FATCA For FFIs (cont'd 6)

- Excepted FFI includes certain:
 - Nonfinancial holdings companies
 - Start-up companies
 - Nonfinancial entities liquidating or emerging from bankruptcy
 - Hedging/financing centers of nonfinancial groups
 - Entities described in Section 501(c)

[See Prop. Reg. 1.1471-5(e)(5)]

Note: Also exempt from NFFE withholding per Prop. Reg. 1.1472-1(c)(1)(vi).

FATCA For FFIs (cont'd 7)

- Intergovernmental Agreements (IGs)
 - July 2012, Treasury released model intergovernmental agreements.
 - Developed in consultation with France, Germany, Italy, Spain, and the United Kingdom.
 - To date, IG signed with U.K. (Sept 2012). Switzerland and Germany have announced intention to sign, as have Guernsey, Jersey and the Isle of Man.
 - Thrust of IGs:
 - FFI reports FATCA information to partner country
 - Information is given to IRS per bilateral tax treaty
 - In mutual IG, U.S. collects tax information for partner country
 - FFIs in partner country are not required to have FFI agreement
 - FFIs report to their own government
 - FFIs generally do not withhold under FATCA - reporting only

FATCA FOR NFFEs

FATCA For NFFEs

- FATCA withholding on all WPs paid to an NFFE unless:
 - the beneficial owner of such payment is the NFFE or another NFFE;
 - the NFFE has no substantial U.S. owners or has identified its U.S. owners; and
 - the withholding agent reports to the IRS.

[Prop. Reg. 1.1472-1(b)]

FATCA For NFFEs (cont'd)

- Exceptions from withholding on WPs to an NFFE that qualifies as:
 - public company
 - affiliate of a public company
 - formed under the laws of a U.S. possession and owned by residents of that possession
 - qualifies as exempt beneficial owner (above)
 - active NFFE
 - less than 50% of gross income is passive, or
 - less than 50% of assets are held for production of passive income
 - excepted FFI (above)
 - withholding foreign partnership or withholding foreign trust

[Prop. Reg. 1.1472-1(c)]

FATCA FOR WITHHOLDING AGENTS



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FATCA For Withholding Agents

- **Withholding agent (WA)** means any person, U.S. or foreign, in whatever capacity acting, that has control, receipt, custody, disposal, or payment of a WP. [Section 1473(4); Prop. Reg. 1.1473-1(d)(1)]
 - WA includes participating FFI and deemed-compliant FFI required to withhold on passthru payment (PTP). [Prop. Reg. 1.1473-1(d)(2)]
 - WA also includes grantor trust with respect to WP or PTP made to OWNER. [Prop. Reg. 1.1473-1(d)(3)]

Note: When multiple persons qualify as a withholding agent, only one tax is required to be withheld. [See Prop. Reg. 1.1474-1(a)]
- Withholding agent is liable for amount of tax not properly withheld and deposited. [Section 1474(a)]
- Documentation/due diligence
 - Classification of payee [Prop Reg 1.1471-3; 1.1472-1(d)]
 - Circumstances under which no withholding is required (above) [Prop. Reg. 1.1471-2(a)(4); 1.1472-1(b)-(c)]
- Information returns [Prop. Reg. 1.1474-1(c)-(d); 1.1472-1(e)]

PRACTICAL IMPLICATIONS

Practical Implications

- Accounts payable
 - Outside ordinary course
 - Financial services
- Investment vehicles
 - Funds
 - Trusts
 - Single purpose investment entities
- Foreign accounts
 - Participating FFI
 - Passthru payments
- Cash management
- Payments to affiliates
- Holding companies

EFFECTIVE DATES/TIMELINE

Proposed Regulations – Phased In Effective Date

- Withholding
 - FDAP - 1/1/14
 - Gross proceeds from U.S. securities - 1/1/15
 - Foreign passthru payments (other than withholdable payments) - 1/1/17 (or later)
- Reporting
 - Name, TIN, account balance for U.S. accounts - Reporting for 2013 in 2014
 - Income associated with U.S. accounts - Reporting for 2015
 - Gross proceeds (full reporting) - Reporting for 2016

Questions

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