

Preparing for FATCA Compliance

04.22.11 01.07.26

Garvey Schubert Barer Legal Update, April 22, 2011.

I. Introduction/Background.

The Foreign Account Tax Compliance Act ("FATCA") was enacted as part of the Hiring Incentives to Restore Employment ("HIRE") Act signed into law on March 18, 2010. As indicated by the UBS Agreement and two offshore voluntary disclosure initiatives, the IRS has increasingly targeted offshore tax evasion. FATCA is the next step in this ongoing battle.

The goal of FATCA is to detect, deter, and discourage offshore tax evasion through increased transparency in the international investment community. To reach that goal, FATCA focuses on disclosure and reporting by foreign entities, particularly foreign financial institutions ("FFI"). FATCA's hammer to obtain taxpayer disclosure and reporting is a 30 percent withholding tax levied on "withholdable payments" to noncompliant FFIs and certain foreign entities. Withholdable payment for purposes of FATCA include any payment of FDAP type income (e.g, interest, service fees, royalties, dividends, premiums, annuities) as well as any gross proceeds from the sale of any property that could produce interest or dividends from U.S. sources.

II. FATCA Impact on U.S. Payors.

Under current law, payors of U.S. source FDAP income are obligated to withhold a 30 percent tax pursuant to Section 1441 and Section 1442, Withholding of Tax on Nonresident Aliens and Foreign Corporations. FATCA will impose an obligation on a U.S. payor to withhold 30 percent on any withholdable payment to FFIs and certain non-financial foreign institutions ("NFFE") unless an exception applies. It is important to note that FATCA withholding is in addition to and not a substitute for Sections 1441 and 1442 withholding.

III. U.S. Individuals Residing Abroad.

FATCA also includes an additional reporting requirement for U.S. individuals. FATCA requires individual taxpayers with an interest in "specified foreign financial assets" valued at more than USD\$50,000 to make disclosure of such assets with their U.S. income tax returns. This reporting requirement is commonly called the "shadow FBAR" rule because it is in addition to the Foreign Bank and Financial Account Report (FBAR) required under the Bank Secrecy Act.

IV. FATCA Impact on FFIs.

FFIs will be the de facto administrators of the FATCA reporting regime. Under FATCA, FFIs will have to report U.S. accounts to the IRS or be subject to a 30 percent withholding tax on any withholdable payments made to the institution. Even an FFI that enters into an agreement with the IRS to provide the requisite information (a "participating FFI") can still be subject to withholding on certain payments.

V. Compliance.

The disclosure and reporting obligations will vary depending on whether an entity is a FFI, an NFFE, a U.S. Payor, or a U.S. individual. To what extent FATCA will pose major costs and burdens depends upon what the final regulations ultimately require.

VI. Conclusion.

The compliance and enhanced reporting requirements under FATCA are many. To be compliant with the new FATCA rules, U.S. payors of FDAP type income may have to update their accounts payable and treasury functions to capture the information necessary to identify payments subject to FATCA. While the FATCA rules are still under development, this alert provides an overview of the FATCA mechanics and application, and the key items that have emerged from the IRS' guidance thus far so that companies and individuals can start considering what they may need to do to bring their accounts payable and treasury functions and personal finances into compliance.

For more information about FATCA or any related issues, please contact Lisa Findlay or any of the other members of the GSB Tax and Benefits Group.

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