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IRS Announces Two-Year Transition Period For Withholding Agents For Purposes of FATCA Enforcement And Administration

On May 2, 2014, the Internal Revenue Service (IRS) provided additional guidance on the implementation of FATCA and its related withholding provisions in Notice 2014-33. Most importantly, Notice 2014-33 announces that the IRS will regard calendar years 2014 and 2015 as a “transition period” for purposes of IRS enforcement and administration of the Foreign Account Tax Compliance Act (FATCA), for withholding agents, foreign financial institutions (FFIs), and other entities with withholding responsibilities that make a good faith effort to comply with the regulations. The transition period is also applicable to certain related due diligence and withholding provisions. While the transition relief does not directly apply to non-US retirement funds, and should not be a reason to slow compliance with FATCA for such retirement funds, nevertheless it may provide some indirect benefit to such funds.

With respect to the new two-year transition period, the IRS stated it will consider whether a withholding agent has made “reasonable efforts” to modify its account operating practices and procedures to document the status of payees, apply the relevant standards of knowledge, and, in the absence of reliable documentation, apply the required presumption rules. Furthermore, the IRS will also consider the good faith efforts of a participating FFI, registered deemed-compliant FFI, or limited FFI to identify and facilitate the registration of each other member of its expanded affiliated group. However, an entity that fails to make good faith efforts to comply with the new requirements will not be given any relief from IRS enforcement during the transition period. What is more, the IRS has stated it will not provide transitional relief with respect to its enforcement regarding a withholding agent’s determinations of the character and source of payments for withholding and reporting purposes.

FATCA, or the Foreign Account Tax Compliance Act, is the controversial piece of US legislation enacted in 2010 as part of comprehensive efforts by the US administration to crack down on concealed financial accounts owned by US taxpayers outside the US. Under the Act, a foreign financial institution (FFI), which has been defined to include retirement funds, is subject to US reporting requirements and a 30% withholding tax on most types of investment income for failure to comply. (More background on how FATCA applies to non-US retirement funds can be found here: <http://www.groom.com/resources-834.html>.)

Implication for Non-US Retirement Plans

Any impact of the good faith transition relief on non-US retirement funds should only be indirect. That is because the transition relief provided by the notice is for the payor of withholdable payments, not the recipient of withholdable payments such as a retirement fund.

Non-US retirement funds, if recipients of withholdable payments (initially, “fixed, determinable, annual, periodic” payments (FDAP), such as dividends, interests, rents and royalties, from US sources), will still need to determine on a timely basis whether they are exempt from withholding under Treasury Regulations or an Intergovernmental Agreement (IGA). Even under the transition relief, it also remains that withholding agents must make good faith efforts to impose FATCA withholding on withholdable payments beginning July 1, 2014 unless the fund can claim an exemption by filing a Form W-8BEN-E with the withholding agent. While it should be rare that a non-US retirement fund is not exempt, sponsors of non-US retirement funds should carefully review their funds through a documented process to show reasonable efforts at compliance and establish how to claim the exemption.

The two-year transition period announced in Notice 2014-33 may provide some indirect relief for non-US retirement funds subject to FATCA withholding, however, as it will allow the financial institutions responsible for withholding on payments to such funds some good faith relief for imperfect efforts to perform withholding on payments to such plans based on arguable or perceived exemptions or to process requests for exemption during this year and the next.

Additional Announcements from Notice 2014-33

In addition to announcing the two-year transition period, Notice 2014-33 also recognizes the intention of the Treasury Department and the IRS to make additional amendments to the FATCA regulations, including, among other things, that a withholding agent or FFI may treat an existing obligation held by an entity that is opened, executed, or issued on or after July 1, 2014, and before January 1, 2015, as a preexisting obligation. Again, these provisions will primarily affect withholding agents, not retirement plans. The IRS has indicated that taxpayers can rely on the provisions of Notice 2014-33 regarding the proposed amendments until the regulations are amended.