

IRS finalizes FATCA regulations on requirements for sponsoring entities

The IRS recently issued final regulations under the Internal Revenue Code regarding the Foreign Account Tax Compliance Act (FATCA). The final regs provide compliance requirements and verification procedures for sponsoring entities of foreign financial institutions (FFIs) and certain nonfinancial foreign entities (NFFEs). They also explain the:

- Certification requirements and procedures for IRS review of certain trustees of trustee-documented trusts,
- Procedures for IRS review of periodic certifications provided by registered deemed-compliant foreign financial institutions, and
- Requirements for certifications of compliance for participating FFIs that are members of two consolidated compliance groups.

The final regs, which became effective on March 25, 2019, contain only limited revisions to proposed regs issued in 2017.

FATCA, generally

The Hiring Incentives to Restore Employment Act of 2010 added Chapter 4 — that is, the FATCA — to the Internal Revenue Code. Under Section 1471(b), a withholding agent is generally required to withhold a 30% tax on certain payments to an FFI unless the FFI:

- Has entered into an FFI agreement with the U.S. to, among other things, report certain information with respect to U.S. accounts (a participating FFI),
- Is treated as complying with the requirements (a deemed-compliant FFI), or
- Satisfies the requirements but elects to be withheld upon rather than withhold on certain payments.

The FATCA rules are essentially a mechanism to enforce reporting requirements. Chapter 4 also imposes withholding, documentation and reporting requirements on withholding agents regarding certain payments made to certain NFFEs.

In cases in which foreign law would prevent an institution from complying with the terms of an FFI agreement, the IRS has collaborated with other governments to develop two alternative model intergovernmental agreements (Model 1 and Model 2 IGAs) that facilitate FATCA implementation. The main distinction between the two is essentially whether the financial institution provides specified information about U.S. accounts to its government, followed by an automatic information exchange with the United States (for Model 1 jurisdictions), or whether the information is reported directly to the IRS (for Model 2 jurisdictions).

Sponsoring entities, etc.

Chapter 4 regs permit certain FFIs and NFFEs to be sponsored by other entities (sponsoring entities) for purposes of satisfying their Chapter 4 requirements. Generally, a sponsoring entity is one that agrees to perform Chapter 4 due diligence, withholding and reporting requirements on behalf of certain FFIs (sponsored FFIs) or Chapter 4 due diligence and reporting obligations on behalf of certain direct reporting NFFEs (sponsored direct reporting NFFEs). An FFI that's a sponsored FFI is a deemed-compliant FFI, and an NFFE that's a sponsored direct reporting NFFE is an excepted NFFE.

The Chapter 4 regs permit a participating FFI that's a member of an expanded affiliated group to elect to be part of a consolidated compliance program under the authority of a:

- Participating FFI,
- Reporting Model 1 FFI, or
- U.S. financial institution that's a member of the same expanded affiliated group (compliance FI).

The compliance FI must establish and maintain the consolidated compliance program and perform a consolidated periodic review on behalf of each member FFI that elects to be part of the consolidated compliance program (electing FFI).

The 2017 proposed regs provide verification requirements (including certifications of compliance) and events of default for sponsoring entities. The proposed regs also provide certification requirements and procedures for IRS review of trustees of certain trustee-documented trusts and procedures for IRS review of periodic certifications provided by registered deemed-compliant FFIs.

In addition, the proposed regs describe the procedures for future modifications to the requirements for certifications of compliance for participating FFIs. And the proposed regs clarify the requirements in the Chapter 4 regs for periodic certifications of compliance for consolidated compliance programs of participating FFIs. They also provide requirements for pre-existing account certifications for these programs.

The final regs

As mentioned, the IRS has now issued final regs regarding FATCA sponsoring entities and related matters. They adopt the proposed regs with limited revisions, including:

Definition of responsible officer. The proposed regs require a sponsoring entity of a sponsored FFI to appoint a responsible officer to oversee the compliance of the entity with respect to each sponsored FFI. They define the term "responsible officer" with respect to a sponsoring entity as an officer of the sponsoring entity with sufficient authority to fulfill the duties of a responsible officer described in the regulations (as applicable).

In the Preamble to the final regs, the IRS acknowledged that, in practice, the person in the best position to know and represent if the sponsoring entity is complying with its obligations under these regs may be an individual other than an officer of the sponsoring entity. This is in keeping with industry practices established by managers and administrators of investment funds and similar vehicles for both Chapter 4 and operational purposes.

Therefore, the final regs define "responsible officer" with respect to a sponsoring entity to include an officer of an entity that establishes and maintains policies and procedures for, and has general oversight over, the sponsoring entity — provided that such individual has sufficient authority to fulfill the duties of a responsible officer described in the regulations (as applicable).

Furthermore, a comment noted that many investment entities don't appoint officers but may appoint directors for corporate governance purposes who would be able to fulfill the requirements of responsible officers. In response, the final regs revise the definition of a responsible officer of a financial institution or sponsoring entity that's an investment entity to include, in addition to an officer of such entity:

- An individual who's a director, managing member or general partner of such entity, or,
- If the general partner or managing member of the investment entity is itself an entity, an individual who's an officer, director, managing member or general partner of such other entity.

Treatment certification by compliance FIs. The final regs clarify that, to the extent a compliance FI or sponsoring entity satisfies the applicable regulatory certification requirements on behalf of an electing FFI, sponsored FFI or sponsored direct reporting NFFE, then the electing FFI, sponsored FFI or sponsored direct reporting NFFE won't have a separate certification requirement under the applicable regulatory certification requirements.

For example, if a participating FFI agrees to be a sponsored FFI, the institution isn't required to submit any certification with respect to its participating FFI status after it's registered as a sponsored FFI by its sponsoring entity. This holds true provided that its sponsoring entity certifies on behalf of the FFI to the extent required under the regulations.

Requirement for a written sponsorship agreement. The proposed regs require a responsible officer of a sponsoring entity to certify that the sponsoring entity is compliant with the requirements of a sponsoring entity and maintains effective internal controls with respect to all sponsored FFIs for which it acts. One of the statements to which the responsible officer must certify is that the sponsoring entity has a written sponsorship agreement in effect with each sponsored FFI authorizing the sponsoring entity to fulfill regulation requirements or an applicable Model 2 IGA.

The final regs provide that the written sponsorship agreement may be part of another agreement between the sponsoring entity and the sponsored FFI provided that it refers to the requirements of a sponsored FFI under FATCA. For example, a provision in a fund manager agreement that states that the sponsoring entity agrees to satisfy the sponsored FFI's FATCA obligations would be sufficient.

Additionally, the proposed regs don't specify when a sponsorship agreement must be in place for purposes of a sponsoring entity's certification requirements. To allow sufficient time for a sponsoring entity to enter into sponsorship agreements (or revise existing agreements), the final regs provide that a sponsoring entity of a sponsored FFI must have the written sponsorship agreement in place with such sponsored FFI by the later of March 31, 2019, or the date when the sponsoring entity begins acting as a sponsoring entity for such sponsored FFI.

The final regs include similar rules for a sponsoring entity of a sponsored direct reporting NFFE regarding the date by which the written sponsorship agreement must be in place and indicate that it need not be a standalone agreement.

Extension of time for certifications for the certification period ending on December 31, 2017. The proposed regs provide that a sponsoring entity of a sponsored FFI or sponsored direct reporting NFFE and a trustee of a trustee-documented trust must make the certifications of compliance described in regulations, as applicable. The certifications must be made on or before July 1 of the calendar year following the end of the certification period.

The proposed regs also provide that a sponsoring entity of a sponsored FFI must submit the pre-existing account certification described in regulations by the due date of the sponsoring entity's certification of compliance for the certification period. The earliest certification period for a sponsoring entity or trustee of a trustee-documented trust ends on December 31, 2017, under the proposed regs, making the earliest certification due date July 1, 2018.

The final regs provide additional time for sponsoring entities to make certifications that would otherwise have been due on July 1, 2018. Under these final regs, certifications by sponsoring entities and trustees of trustee-documented trusts for the certification period ending on December 31, 2017, must be submitted on or before March 31, 2019.

The IRS's "FATCA — FAQs General" Web page was updated on March 20, 2019, to provide, in question Q20, that, for purposes of completing the certifications required for the certification period ending December 31, 2017, a sponsoring entity may rely on the rules provided in the proposed regs.

Terminated sponsoring entities. The proposed regs provide that, if a sponsoring entity of a sponsored FFI is terminated by the IRS, the sponsored FFI of the terminated sponsoring entity can't register as a sponsored FFI of a sponsoring entity that has a relationship described in Sec. 267(b) with the terminated sponsoring entity unless the sponsored FFI obtains written approval from the IRS. The proposed regs provide a similar rule regarding a terminated sponsoring entity of a sponsored direct reporting NFFE, but don't permit the sponsored direct reporting NFFE to obtain written approval from the IRS to register as a sponsored direct reporting NFFE of a Sec. 267(b)-related sponsoring entity.

The final regs make two changes to this rule. First, they provide that the rules described above generally prohibit registration by a sponsored FFI or sponsored direct reporting NFFE under a sponsoring entity that has a relationship described in Sec. 267(b) or Sec. 707(b) to the terminated sponsoring entity. Thus, for example, a sponsored FFI of a terminated sponsoring entity that's a partnership can't register under another sponsoring entity that's a partnership if the same person owns, directly or indirectly, more than 50% of capital interests or profits interests of both sponsoring entities.

Second, the final regs conform the rule for sponsored direct reporting NFFEs with the rule for sponsored FFIs by allowing a sponsored direct reporting NFFE to register under a sponsoring entity, notwithstanding that there's the impermissible relationship described above, if the sponsored direct reporting NFFE obtains written approval from the IRS.

Sponsored entities located in a Model 1 IGA jurisdiction. The Preamble to the proposed regs provides that a financial institution covered by a Model 1 IGA that chooses to qualify as a sponsored FFI under regulations, instead of Annex II of the Model 1 IGA, must satisfy all requirements of the regs applicable to such an entity.

Comments requested that a financial institution located in a jurisdiction with a Model 1 IGA that doesn't include a sponsored entity as a type of nonreporting financial institution in Annex II be allowed to comply with local guidance on sponsored entities or the Model 1 IGA Annex II rather than the regs. In the Preamble to the final regs, the IRS states that it's open to discussing the issue with the competent authorities of affected jurisdictions.

Important compliance

The FATCA is an important part of the federal government's efforts to combat tax evasion by U.S. persons holding accounts and other financial assets offshore. If you're a taxpayer holding financial assets outside the United States, or a foreign financial institution, work closely with your CPA to understand the law and comply with all requirements. •