

Evolution of FATCA: How We Got Here and Where Are We Going?

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Introduction

Welcome!

Presenters

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How to Submit Your Questions

Agenda

- **What is FATCA?**
- **History of FATCA**
- **Development of FATCA**
- **General Rules:**
 - **IRC Sections 1471, 1472, 1473 and 1474**
- **Notice 2010-60**
- **Notice 2011-34**
- **Going Forward – Unresolved Issues**
- **Questions from the Audience**
- **Closing**

What is FATCA?

- The Foreign Account Tax Compliance Act was enacted as part of the Hiring Incentives to Restore Employment Act (PL 111-147) in March 2010.
- FATCA is a sea change approach to international tax compliance intended to thwart offshore tax evasion by giving the IRS tools to identify US owners of foreign accounts and entities.

- **Carrot and Stick:**



- Carrot: Foreign financial institutions (“FFIs”) and non-financial foreign entities (“NFFEs”) agree to tell the IRS about their US account holders and owners, or

- Stick: 30% withholding tax on all “withhholdable payments” they receive.



- FATCA includes several other provisions aimed at improving offshore compliance, beyond the scope of this webinar.

History of FATCA

- FATCA was the result of a “perfect storm” of world events, technological changes, the economic crisis and political pressure to curb offshore tax abuse
- Existing law and administrative authority were insufficient to detect and deter offshore tax evasion
- An innovative approach attempting to overcome sovereign barriers to encourage voluntary compliance

Development

- GAO Reports
- Hearings
- Legislative Proposals
- Staff Draft
- Green Book
- Drafting
- Stakeholder Input
- Timing

General Rules

- **Foreign Financial Institutions:** 30% withholding tax on “withholdable payments” to a Foreign Financial Institution (“FFI”) unless it agrees (under an “FFI Agreement”) to obtain and provide information on “US accounts” to the IRS each year
- **Non-Financial Foreign Entity:** 30% withholding tax on “withholdable payments” if beneficial owner is a Non-Financial Foreign Entity (“NFFE”), unless NFFE provides withholding agent with information on each of its beneficial owners that is a “substantial United States owner” (or certifies that it has no such owners)
- Generally effective for payments after December 31, 2012
- Secretary granted authority to issue regulations and guidance as necessary and appropriate to carry out purposes of, and prevent avoidance of, rules.
 - Notice 2011-34, April 8, 2011
 - Notice 2010-60, September 13, 2010

General Rules – Foreign Financial Institutions

- **General rule:** 30% withholding tax on “withholdable payments” to a Foreign Financial Institution (“FFI”) unless it agrees (under an “FFI Agreement”) to obtain and provide information on “US accounts” to the IRS each year
- Reporting requirements: FFI agrees to ...
 - Obtain necessary information to identify US accounts
 - Comply with verification and due diligence procedures
 - Report required information annually to the IRS
 - Deduct and withhold 30% tax on “passthru payments”
 - Comply with requests by Secretary for additional information
 - Obtain a waiver from the account holder or close the account, if foreign law prevents such reporting.
- Secretary has authority to terminate agreement for noncompliance

General Rules – Foreign Financial Institutions

- **Foreign Financial Institution:** any foreign entity that
 - A. accepts deposits in the ordinary course of a banking or similar business,
 - B. as a substantial portion of its business, holds financial assets for the account of others, or
 - C. 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 in any of these.
- Final category includes hedge funds and other private funds

General Rules – Foreign Financial Institutions

- **US Account:** any financial account held by one or more specified United States persons or United States owned foreign entities.
- **Financial Account:** with respect to any FFI,
 - any depository account maintained by such financial institution,
 - any custodial account maintained by such financial institution, and
 - any equity or debt interest in such financial institution (other than interests regularly traded on an established securities market).

General Rules – Foreign Financial Institutions

- **Specified United States person:** Any US person other than publicly traded corporations, their affiliates, tax-exempt organizations, governments, banks, real estate investment trusts, regulated investment companies, common trust funds, and certain trusts.
- **United States owned foreign entity:** any foreign entity with one or more substantial United States owners (generally, greater than 10% owner).
 - No 10% threshold with foreign investment vehicles

General Rules – Foreign Financial Institutions

- **Withholdable payment:**
 - **US-Source FDAP:** Interest (including OID), dividends, rents, and other passive income (referred to as “fixed or determinable annual or periodic” or “FDAP” income), from sources within the United States
 - **Gross proceeds:** Gross proceeds from the sale or other disposition of any property of a type that can produce US source interest or dividends
- Income connected with a US business is excepted
- Interest paid by a foreign partnership is treated as US source income

General Rules – Foreign Financial Institutions

- **FATCA withholding and tax treaties:**
 - FFIs entitled to a reduced rate of tax under a treaty may not receive a refund greater than the amount of credit attributable to the reduced rate, and no interest on the refund is allowed.
 - No refunds are allowed unless the beneficial owner of the payment provides the necessary information to the Secretary to establish whether the beneficial owner is a US owned foreign entity and the identity of any substantial US owners of such entity.

General Rules – Non-Financial Foreign Entities

- **General rule:** 30% withholding tax on “withholdable payments” if beneficial owner is an NFFE, unless NFFE provides withholding agent with information on each of its beneficial owners that is a “substantial United States owner” (or certifies that it has no such owners)
 - Information on each substantial US owners: name, address, TIN
 - Withholding agent must not know, or have reason to know, certification is incorrect, and must agree to report name, address and TIN of each substantial US owner to IRS.
- **Exceptions:** No withholding on payments to publicly traded corporations, entities established under the rules of a US possession, foreign governments, international organizations, foreign central banks of issue, and classes of persons or payments identified by the Secretary as having a low risk of tax evasion

General Rules – Non-Financial Foreign Entities

- A **“withholding agent”** means:
 - All persons in whatever capacity having control, receipt, custody, disposal, or payment of any withholdable payment.
- A **“substantial US owner”** means:
 - Any specified US person owning, directly or indirectly, more than 10% of the stock of a corporation, by vote or value;
 - Any specified US person owning, directly or indirectly, more than 10% of the profits or capital interests in a partnership;
 - Any specified US person treated as an owner of any portion of a trust; and
 - No 10% threshold for FFIs engaged in investing.

Procedures to identify pre-existing US accounts

- **Notice 2011-34, Section I, substantially modifies the rules to identify US accounts.**
 - Unless the FFI elects otherwise, a US account does not include any depository account if each holder of the account is a natural person and the aggregate value of all depository accounts held by the account holder with the FFI is not greater than \$50,000.
 - For purposes of this \$50,000 test, only accounts that can be identified with the FFI's existing computer information must be aggregated, and account balance is measured at the end of the preceding year, not quarterly.
 - Accounts already identified as US accounts will be considered US accounts.
 - New and stringent rules for private banking accounts.
 - Private banking account managers must go through a series of steps to establish whether an account is a US account by the end of the first year the FFI Agreement is in effect.
 - Must conduct a "diligent review"; must treat all accounts with US indicia as US accounts if non-US status is not established; and must maintain a list of clients whose accounts are US, non-US, or recalcitrant.

Procedures to identify pre-existing US accounts

- If the status has not clearly been determined, FFIs must conduct a thorough electronic search for US indicia; for files with US indicia, procedures similar to those required for private banking accounts must be completed within one year of the effective date of the FFI Agreement; account holders failing to provide requisite information within two years of the FFI Agreement will be classified as recalcitrant.
- Unresolved “high-value” accounts with balances or values of \$500,000 or more are subject to “diligent” reviews.
- An officer of the FFI must certify to the IRS that the procedures have been completed within the required time frames (one year for US accounts, non-US accounts and private banking accounts; two years for accounts with US indicia and high value accounts), and that no actions were taken to avoid identifying US accounts.
- Withholding on recalcitrant accounts is not intended to be a permanent substitute for collecting information necessary to identify US accounts.

Passthru Payments

- Background
 - Comments to original version of FATCA noted that an FFI might be subject to withholding on all withholdable payments because it was unable to obtain information on a small number of uncooperative account holders
- Passthru Payments
 - Under final legislation, FFI must withhold 30% from any “passthru payment” made by the FFI to any “recalcitrant holder” or non-participating FFI
 - Recalcitrant holder: account holder who fails to fails to comply with reasonable requests for identifying information, or who fails to waive any requirement of foreign law that would prevent disclosure of information about that holder to the IRS
 - A participating FFI may elect to be withheld upon rather than withhold on payments to recalcitrant account holders and nonparticipating FFIs with respect to all, or certain classes and types of, accounts.

Passthru Payments

- Passthru payment: any withholdable payment or other payment to the extent attributable to a withholdable payment
- Notice 2011-34, Section II, provides first attempt at describing when a payment is “attributable to” a withholdable payment
 - Based on “passthru payment percentage”: ratio of FFI’s US assets to total assets
 - Notice rejects direct tracing approach as too limited
 - US asset: any asset to the extent that it is of a type that could give rise to a passthru payment
 - But FFI’s debt or equity interest in a domestic corporation will be treated solely as a US asset
 - FFI’s debt or equity interest in an NFFE will be treated solely as a non-US asset

Deemed-Compliant FFIs

- Notice 2011-34, Section III, establishes three limited categories of “deemed-compliant” FFIs
 - Local Banks
 - Local FFI Members of Participating FFI Groups
 - Certain Investment Vehicles
- FFIs must apply for deemed-compliant status with the IRS, obtain an FFI number identifying it as deemed-compliant, and re-certify every three years.
- **Local Banks:** Each FFI in an expanded affiliated group if ...
 - Each FFI is a depository institution
 - All FFIs are organized in the same country
 - No FFI maintains operations outside that country
 - No FFI operates or solicits account holders outside that country
 - Adequate policies and procedures are in place to ensure accounts are not opened for non-residents, nonparticipating FFIs, and NFFEs.

Deemed-Compliant FFIs

- **Local FFI Members of Participating FFI Groups:** Any FFI that is a member of an expanded affiliated group that includes one participating FFI if
 - the FFI member does not maintain operations or solicit account holders outside its country of organization
 - the FFI member implements the pre-existing account and customer identification procedures required of participating FFIs to identify:
 - U.S. accounts
 - accounts of non-participating FFIs, and
 - accounts of NFFEs
 - If any of these are found, the FFI agrees to enter into an FFI Agreement, transfer such accounts to a participating FFI affiliate, or close such accounts

Deemed-Compliant FFIs

- **Collective investment vehicles:**
 - all direct interest holders of record are participating FFIs or deemed-compliant FFIs holding fund interest on behalf of other investors, or entities exempt from withholding under section 1471(f) (foreign governments, international organizations, etc.)
 - the fund prohibits the subscription for or acquisition of any interests in the fund by any other person
 - the fund certifies that it will calculate any passthru payment percentages in accordance with Section II of Notice 2011-34
- **Documented FFI:** Notice 2010-60 - deemed-compliant if withholding agent
 - Specifically identifies each individual, specified US person, or excepted NFFE (an NFFE somehow excused from FATCA reporting and withholding) that has a direct or indirect interest in such entity
 - Obtains from each such person the documentation that would be required from a new account holder or a direct payee
 - Reports to the IRS any such specified US person

Other Exceptions

- Note that status as a Deemed-Compliant FFI is not the only complete or partial exception to the FATCA rules
 - Section 1471(f): no withholding on payments to any class of persons identified as posing low risk of tax evasion
 - Section 1471(d)(5): Exception to term “Financial Institution” (but then entity may still be NFFE)
 - Section 1472(c): No NFFE withholding on
 1. any payment beneficially owned by an identified class of persons, or
 2. any class of payments identified by the Secretary as posing a low risk of tax evasion
- Notice 2010-60 carved following out of Section 1471 and 1472:
 - Certain holding companies; Start-up companies; Non-financial entities liquidating, emerging from reorganization or bankruptcy; Hedging/financing centers of a non-financial group
- Notice 2010-60 also addressed Territory-Organized FFIs, Insurance Companies

Procedures for Reporting on US Accounts

- Information Required to be Reported under Section 1471
 - Name, address and TIN of each US account holder and each substantial US owner of a US-owned foreign entity account holder;
 - Account number;
 - Account balance or value as determined by the Secretary;
 - Gross receipts and gross withdrawals of payments from the account, except as provided by the Secretary; and
 - Election available to be subject to the same reporting rules as US financial institutions, as if the FFI were a US financial institution and each US account holder is a natural person and citizen of the US

Procedures for Reporting on US Accounts

- Under Notice 2011-34, Section IV
 - Reporting limited to year-end account balances or values.
 - Gross receipt and withdrawal data not required to be reported; instead, gross dividends, interest, other types of income, and gross proceeds from the sale or redemption of property must be reported. Amounts and character are not required to comport with US tax law.
 - Withdrawals and transfers must be reported for closed or transferred accounts

Qualified Intermediaries

- Notice 2011-34, Section V, requires existing and new Qualified Intermediaries to agree to become participating FFIs, unless they are deemed-compliant.
- Qualified Intermediaries are subject to both QI and FFI rules.
- A US account is any financial account held by one or more specified US persons or US owned foreign entities.
- For purposes of determining when the aggregate value of all depository accounts held by an account holder with an FFI is not greater than \$50,000, members of the same expanded affiliated group are treated as a single FFI.
- Rules to avoid duplicative reporting.

Procedures for Affiliated Groups of FFIs

- The reporting requirements generally apply to all FFIs in the same expanded affiliated group, as defined by IRC section 1504 (substituting 50% for 80%), and section 954(d)(3)
- Section VI includes procedures for affiliated groups of FFIs.
 - Each FFI in an expanded affiliated group must be a participating FFI or a deemed-compliant FFI.
 - Each FFI will receive a unique FFI-EIN and be responsible to comply with the FATCA rules.
 - IRS intends to establish procedures for a “lead” FFI.
 - IRS may also permit centralized compliance option for funds with a common asset manager or other agent

Effective Date of FFI Agreements

- Notice 2011-34, Section VII, provides that FFI Agreements are effective on the later of the date they are executed or the effective date of the FATCA legislation.
 - Generally, payments made after December 31, 2012.

Unresolved Matters

- What information will the FFI Agreements, information reporting forms, and certification forms require?
- How will the IRS database of participating FFIs operate?
- Will the effective date be delayed? What would a delay look like?

Unresolved Matters

- **Treasury still seeking guidance to resolve or streamline rules and procedures.**
 - Private banking accounts
 - Treatment of insurance companies
 - Termination of FFI Agreements with long-term recalcitrant accounts
 - Alternative procedures for passthru payments, including exceptions
 - How to determine US assets
 - Anti-abuse rules
 - Deemed-compliant standards
 - Identification of low-risk activities and investments
 - Coordination of FATCA and QI rules and procedures
 - Expanded affiliated group rules
- **Written comments due June 7, 2011**

Closing

- **Thank you!**
- **For more information, see our alert included in this attachment:**
 - “New Guidance on FATCA Clarifies Intent but Unresolved Issues Create Challenges for Timely Implementation”
- **Or contact:**
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New Guidance on FATCA Clarifies Intent but Unresolved Issues Create Challenges for Timely Implementation

The Hiring Incentives to Restore Employment Act of 2010, enacted on March 18, 2010, contains sweeping new legislation aimed at thwarting offshore tax evasion by US persons. The cornerstone of these provisions, known as the Foreign Account Tax Compliance Act (“FATCA”), establishes a new reporting and withholding regime intended to encourage voluntary tax compliance by making US ownership of offshore accounts and foreign entities more transparent to the IRS. The burden of this new regime falls mainly on foreign financial institutions (“FFIs”), including offshore hedge funds and other offshore commingled investment vehicles, and on non-financial foreign entities (“NFFEs”), which will be required to tell the IRS about their US account holders and owners and implement procedures to ensure the completeness of this information, or otherwise to face a 30% withholding tax on certain payments (referred to as “withholdable payments”). On April 8, 2011, Treasury issued Notice 2011-34, its second notice providing guidance on the many interpretative and implementation details of FATCA that were delegated to Treasury. Notice 2011-34 (and Notice 2010-60, the September 13, 2010 guidance that it modifies and supplements) provides preliminary guidance – particularly on the procedures for FFIs to identify US persons among their existing account holders and owners, with special rules for private banking accounts, and the calculation of withholding on “passthru payments” made by the FFI – and signals Treasury’s intentions for future regulations. The two notices, however, leave many questions that will need to be answered as FFIs, NFFEs, and US withholding agents begin to commit resources so they can comply with the new reporting requirements and avoid a stiff US withholding tax.

Background on FATCA and Concerns for Private Funds

Passed in the shadow of the contentious health care bill, FATCA attempts to compel FFIs and NFFEs to help curb US tax evasion by imposing a 30% withholding tax on “withholdable payments” to them if they fail to obtain and report information about their “US accounts” annually to the IRS. The information sharing agreement that the FFI enters into with the IRS is called an “FFI Agreement.” The FATCA provisions are generally effective for applicable payments made after December 31, 2012, and cast a wide net. The term FFI is defined as any foreign institution that

- accepts deposits in the ordinary course of a banking or similar business,
- as a substantial part of its business, holds financial assets for the account of others, or
- is engaged (or holds itself out as being engaged) primarily in the business of investing, reinvesting, or trading in securities, partnership interests, commodities or any interest therein.

This final category of FFI would cover hedge funds, funds-of-funds, and other private funds. An NFFE is any foreign institution that is not an FFI; to avoid

withholding, an NFFE generally must report information on its 10% owners who are US persons (“substantial United States owners”).

A “US account” is any “financial account” held by one or more “specified United States persons” or “United States owned foreign entities.” A financial account is a depository or custodial account and any debt or equity interest in an FFI (other than interests that are regularly traded on an established securities market). Because a private fund is included in the definition of FFI, an equity interest in a private fund would generally be treated as a financial account for this purpose. A specified United States person is essentially any US person, other than publicly traded corporations, their affiliates, tax-exempt organizations, governments, banks, real estate investment trusts, regulated investment companies, and common trust funds. A United States owned foreign entity is a foreign entity with one or more “substantial United States owners,” generally defined as an owner of a greater than 10% interest. The 10% threshold, however, does not apply if the foreign entity is an investment fund. Thus, the interest of any US person in a foreign private fund would be a US account for this purpose.

A withholdable payment is (1) any U.S.-source payment of interest, dividends and other similar passive income (referred to generally as “fixed and determinable annual or periodical” or “FDAP” income) and (2) any gross proceeds from the sale or other disposition of any property of a type that can produce U.S.-source interest or dividends. The first category is broader than the similarly defined category that is currently subject to withholding, because FATCA does not reflect the exclusion for portfolio interest. The second category is new, reaching payments to a non-US person even when property is sold at a loss.

For more details, please see our previous alert, [“Provisions in HIRE Act Aimed at Offshore Tax Evasion Will Have Far-Reaching Impact on Private Investment Funds and Swap Participants.”](#)

For private funds, the main points of interest in Notice 2011-34 are:

- the complex and expansive rules for calculating the “passthru payment percentage,” which will determine how much US tax a foreign private

fund will need to withhold on payments to its owners (discussed in Section II below);

- private funds seem unlikely to be granted blanket relief, because the category of deemed-compliant FFIs is quite limited (discussed in Section III below); and
- Treasury and the IRS are considering creating a centralized compliance option, so that the asset manager for a group of funds could undertake compliance for those funds (discussed in Section VI below).

In addition, Notice 2011-34 creates special and stringent procedures to identify US persons with private banking accounts at FFIs.

The remainder of this alert discusses the guidance contained in the seven sections of Notice 2011-34.

Section I: Procedures to be Followed by Participating FFIs in Identifying US Accounts Among Their Existing Accounts

Notice 2011-34 substantially modifies the procedures described in Notice 2010-60 for FFIs to identify US accounts among their existing individual accounts. It also imposes a new procedure requiring participating FFIs to certify that they have completed the requirements to determine the status of their existing accounts. In addition, the Notice creates special and stringent procedures to identify US persons with private banking accounts. The key is that the FFI must have procedures to identify US persons among its account holders (or owners, in the case of a private fund); a foreign entity without any actual US owners is not excused from these requirements. Thus, the procedures described in the notice, although somewhat numbing in their scope, are significant in assessing the burden that will be placed on FFIs.

A participating FFI must determine whether existing individual accounts are US accounts, non-US accounts or recalcitrant accounts (that is, holders who do not provide information about themselves or who do not agree to waive any provision of foreign law that would prevent the disclosure of information about that holder to the IRS). An FFI may rely on documentation collected or otherwise maintained in

an account holder's files, unless the FFI knows, or has reason to know, the information is unreliable. In general, FFIs meet document maintenance requirements by keeping either a copy of the documents or a record of the evidence that was examined; however, a Form W-8BEN (used by non-US persons to certify their non-US status and, where applicable, claim treaty benefits) is maintained only if a copy is kept on file.

In general, accounts held by individuals already identified by FFIs as US persons for other US tax purposes will be considered US accounts. In addition, certain smaller accounts – depository accounts where each account holder is a natural person, with a balance or value as of the end of the calendar year preceding the effective date of the FFI Agreement that does not exceed \$50,000 – will be treated as non-US accounts regardless of their actual status, unless the FFI elects otherwise. For purposes of applying the \$50,000 account balance or value test, FFIs are required to treat as a single account only those accounts that can be identified with the FFI's existing computer information. The account balance or value is measured as of the end of the calendar year preceding the date of the FFI Agreement rather than the preceding year's average monthly balance or value as defined in Notice 2010-60.

Perhaps pointing to a practice that Treasury considers to constitute a higher risk of offshore noncompliance, Notice 2011-34 introduces special and stringent procedures to identify any US person with a "private banking account," defined as any account maintained or serviced by an FFI's private banking department or maintained or serviced as part of a private banking relationship. Because a private banking account can include an account held by an entity, nominee, or other person to the extent the account is associated with the private banking relationship with an individual client, it appears that these procedures could apply to an interest in an offshore investment fund. An FFI is not entitled to rely on documentation submitted by such a client if the private banking relationship manager knows, or has reason to know, that the information is unreliable or incorrect. Private banking relationship managers are required to complete a series of steps to establish the nature of a private account, including identifying any clients for which the manager has

actual knowledge the client is a US person; diligently reviewing paper and electronic files to locate indicia of US status (see below); obtaining a Form W-9 from US citizens and lawful US residents; in the case of persons born in the US or with a US address, obtaining a Form W-9 to establish US status, or a Form W-8BEN and a non-US passport (or other similar government-issued evidence establishing citizenship in a country other than the US); and securing a written explanation from the client regarding the client's renunciation of US citizenship or why the client was not a US citizen at birth. Private banking managers must treat all of a client's accounts as US accounts if the client is identified as having US indicia and does not establish non-US status, and also are required to create and maintain lists of all existing clients whose accounts are US accounts, non-US accounts or recalcitrant accounts. Procedures for private banking accounts must be completed by the end of the first year the FFI Agreement is in effect, and written requests and responses in connection with the search for US indicia must be retained by the FFI for ten years.

For all accounts not clearly identified as US accounts, non-US accounts or private banking accounts, FFIs must determine whether electronically searchable information contains certain US indicia, including US citizenship or residency; US place of birth; standing instructions to transfer funds to an account in the US; an "in care of" or a "hold mail" address that is the sole address for the account holder; or a power of attorney granted to a person with a US address. Scanned documents or .pdf files are not automatically considered electronically searchable. For such files with US indicia, procedures similar to those required for private banking accounts must be followed to establish non-US status within one year of the effective date of the FFI Agreement. The notice broadens and clarifies what is acceptable documentary evidence to establish non-US status. Non-US status can be established by any valid document issued by an authorized governmental body that includes the individual's name and address and is typically used for identification purposes, as well as identification documents that are approved for use in the IRS's Qualified Intermediary program. Account holders failing to provide requisite information to establish non-US

status within two years of the FFI Agreement will be classified as recalcitrant.

The FFI must conduct a diligent review of the account files of all preexisting individual accounts that are not clearly identified as US accounts, non-US accounts, private banking accounts, or accounts with US indicia, with a balance or value of \$500,000 or more at the end of the year preceding the effective date of the FFI Agreement. The guidance does not specify whether this applies to both electronic and paper files; however, in the context of other reviews required under the notice, files in all formats would appear to be subject to the review. Reviews of prior and new high value accounts must be performed annually, beginning in the third year following the effective date of the FFI Agreement.

An officer of the FFI must certify to the IRS when the FFI has completed the procedures for its preexisting individual accounts within one year after the effective date of the FFI Agreement for US accounts, non-US accounts and private banking accounts, and within two years for accounts with US indicia and high value accounts. The officer also must certify that FFI management did not engage in any activity, or have any formal or informal policies and procedures, to direct, encourage or assist account holders to avoid identification of their accounts as US accounts, and that written policies and procedures were in place as of the effective date of the FFI Agreement prohibiting employees from advising US account holders in avoidance tactics.

The notice observes that withholding on recalcitrant account holders is intended to provide relief for participating FFIs that otherwise would be proscribed from the program. The notice clarifies, however, that withholding on recalcitrant accounts is not intended to be a permanent substitute for collecting the information necessary to identify US account holders.

Section II: Procedures to Identify and Withhold on Passthru Payments

Notice 2011-34 sets forth Treasury's first attempt at establishing rules for determining when payments made by an FFI are "attributable" to withholdable payments received by the FFI. These complex rules will determine how much US tax an FFI must withhold when it receives withholdable payments

and makes payments to its account holders. For example, a foreign private fund will need to withhold US tax from the portion of its distributions to its owners that is attributable to withholdable payments (such as US-source dividends or gross proceeds from the sale of US stock) received by the fund.

As part of its information-sharing agreement with the IRS, an FFI must agree to withhold on "passthru payments" made to recalcitrant account holders or other FFIs that have not entered into information-sharing agreements ("non-participating FFIs"). The FFI would not need to withhold on payments to any other account holder, such as a US tax-exempt investor in an offshore fund that has provided required certifications as to its identity. A passthru payment is any withholdable payment or any other payment to the extent attributable to a withholdable payment. For example, an FFI receiving a US-source dividend would withhold on payments the FFI makes to recalcitrant account holders to the extent those payments are "attributable" to the US-source dividend. Alternatively, a participating FFI may elect to provide information so that a withholding agent (including another FFI) can determine, and withhold tax from, the portion of any passthru payment allocable to recalcitrant account holders and non-participating FFIs. Without these mechanisms for withholding on passthru payments (which were not included in the original version of the FATCA legislation), an FFI might face withholding on all withholdable payments it receives, even if the information-sharing problems resulted from the actions of only a small number of account holders.

Notice 2011-34 adopts an approach based on the ratio of US assets to total assets (the "passthru payment percentage"), rather than an approach that would subject passthru payments to withholding only if they are directly traceable to withholdable payments. Treasury felt that a direct tracing approach would fail to address account holders who invest in US assets indirectly (one of the purposes of the rule as described in Notice 2010-60) and might result in the use of participating FFIs as "blocker" entities to circumvent the rule.

Under Notice 2011-34, an FFI will generally multiply its payments by its passthru payment

percentage (or, when the FFI acts as custodian, the passthrough payment percentage of the entity that issued the interest or instrument) to determine the portion that is a passthrough payment. Any payment by the FFI that is itself a withholdable payment will also be a passthrough payment. An FFI's passthrough payment percentage will generally be the sum of its US assets held at the end of each quarter, divided by the sum of its total assets held at the end of each quarter. These quarterly testing dates are either the last redemption date of the quarter for entities that permit redemptions at least quarterly, or the last business day of each quarter for other entities. A simplified rule may apply in the first year of an FFI Agreement. Assets are determined based on the method of accounting used for reporting to the FFI's interest holders, plus off-balance sheet transactions or positions to the extent provided in future guidance, but not assets held in custodial accounts of the FFI. For this purpose, a US asset is any asset to the extent that it is of a type that could give rise to a passthrough payment, except that a debt or equity interest in a US corporation will be treated solely as a US asset and a debt or equity interest in a NFFE will be treated solely as a non-US asset. A US asset would include an interest in a lower-tier FFI.

Within three months after its quarterly testing dates, each participating FFI must make its passthrough payment percentage calculations available on a website or database readily searchable by the public. If a participating FFI fails to publish these calculations, its percentage will be considered 100% (meaning that all applicable payments by that FFI would be treated as withholdable payments).

Section III: Procedures to Classify Certain Categories of FFIs That Are Deemed-Compliant

To avoid unnecessary reporting and undue burdens, FATCA authorizes the Secretary to classify certain categories of FFIs as "deemed-compliant." FFIs meeting such criteria are exempted from the FATCA reporting and withholding rules. Under the notice, the category of deemed-compliant FFIs is limited.

Notice 2011-34 specifies that FFIs must apply for deemed-compliant status with the IRS, obtain an FFI identification number from the IRS identifying it as a deemed-compliant FFI, and certify every three

years to the IRS that it meets the requirements for such status. The notice expresses Treasury's intent that each FFI in an expanded affiliated group will be treated as deemed-compliant if certain requirements are met, including that each FFI is a depository institution; all FFIs in the group are organized in the same country; none of the FFIs operates outside of that country; none of the FFIs solicits account holders from outside of the country; and policies and procedures are in place to ensure accounts are not opened or maintained for non-residents, non-participating FFIs, and NFFE. Similar rules are provided for any FFI that is a member of an expanded affiliated group that includes one participating FFI and that meets the requirements listed above.

Treasury also intends that certain collective investment vehicles and other investment funds will qualify for deemed-compliant status if all account holders of record of direct interests in the fund are participating FFIs or deemed-compliant FFIs, other persons are prohibited from subscribing or acquiring interests in such fund, and the fund certifies that any passthrough payment percentages it calculates and publishes will comply with Treasury standards.

The notice provides that participating FFIs and deemed-compliant FFIs may use agents to comply with the FATCA performance and due diligence requirements. However, the FFIs are ultimately responsible for meeting their obligations under the law.

Section IV: Procedures to be Followed by Participating FFIs When Reporting on US Accounts

Notice 2011-34 substantially modifies the preliminary guidance in Notice 2010-60 regarding reporting on US account balances. In response to comments that some FFIs do not maintain monthly account balances, the most recent guidance limits reporting to year-end account balances or values. Because many FFIs do not maintain gross receipt and withdrawal data, Treasury has exercised its authority granted in the statute to modify the information required to be reported to include amounts paid or credited to an account as gross dividends, gross interest, other types of income, or gross proceeds from the sale or redemption of

property. The amount and character of such income generally is not required to conform to US tax law. If a US account is closed or transferred in its entirety during the year, the FFI must report the amount or value withdrawn or transferred. FFIs will not be required to report the basis in the account under such circumstances.

Section V: Procedures for Qualified Intermediaries, Foreign Withholding Partnerships and Foreign Withholding Trusts

A qualified intermediary (“QI”) that is an FFI also is subject to the FATCA rules. FFIs currently acting as QIs will be required to include in their QI agreements that they agree to become participating FFIs as of January 1, 2013 unless they are deemed-compliant FFIs. New QIs will be required to be participating FFIs. Similar rules will apply to Foreign Withholding Partnerships and Foreign Withholding Trusts.

Section VI: Procedures for Expanded Affiliated Groups of FFIs

The FATCA withholding, reporting and other requirements generally apply to the US accounts of each FFI in the same expanded affiliated group, determined by a fifty-percent voting and value test. Similar control tests apply to partnership and other entities. Notice 2011-34 provides that each FFI in an expanded affiliated group will be required to be a participating FFI or a deemed-compliant FFI. Each FFI in the group will be issued its own FFI-EIN and be responsible for its own due diligence, withholding and reporting obligations. The IRS intends to institute a coordinated application process for FFIs in expanded affiliated groups, with a “lead FFI” responsible for supplying information,

applications and other documentation on behalf of each FFI in the group. After the FFI Agreement has been executed, the lead FFI will serve as the IRS contact point for the group unless other FFI affiliates have been so designated. FFI groups also may have the option to designate an FFI within the group to assume an oversight role, establishing policies and procedures to meet FATCA requirements, and monitoring compliance with the FFI Agreement.

A similar centralized compliance option may be instituted for certain collective investment funds that are associated with a common asset manager or other agent. Under this option, the common asset manager or other agent would execute a single FFI Agreement on behalf of each member of the group of funds.

Section VII: Effective Date of FFI Agreements

Notice 2011-34 provides that FFI Agreements will become effective on the later of the date they are executed, or the effective date of the FATCA legislation (generally payments made after December 31, 2012).

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Circular 230 Notice

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