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Lawrence A. Kogan on
FATCA Imposes Not-So-Insubstantial Burdens on Non-Financial Foreign Entities ("NFFEs") - Some Examples

2013 Emerging Issues 6875

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Introduction:

This article focuses on the information gathering, reporting and potential withholding obligations the Foreign Account Tax Compliance Act of 2010 ("FATCA") and accompanying regulations effectively impose on the many different types of nonfinancial foreign entities ("NFFEs" – entities other than financial institutions)¹ operated by U.S. taxpayers overseas. FATCA was designed, in part, to address the longstanding difficulties U.S. and foreign withholding agents have had in identifying the U.S. beneficial owners of U.S. source income paid through foreign entities such as foreign corporations, partnerships and trusts.

As I wrote in a recent EIA,² the U.S. Congressional Joint Committee on Taxation³ reported that U.S. taxpayers had frequently hidden behind foreign entities or offshore accounts posing as foreign citizens to secure eligibility for treaty-based withholding tax reductions or exemptions.⁴ Due to a combination of taxpayer noncooperation and foreign bank secrecy laws, withholding agents had often been unable to discern whether the payee⁵ actually functioned as an intermediary for the benefit of the real owner, whether the payee possessed U.S. or foreign status, whether the payment could reasonably be associated with proper documentation and whether withholding or backup withholding was necessary in the absence of proper documentation.⁶

1 See [26 USC 1472](#)(d).

2 See Lawrence A. Kogan, *U.S. FATCA Information Reporting: A Pretext for Fishing With Like-Minded European and OECD Nations For Long Forsaken Tax Revenues at Exotic Offshore Locations*, LexisNexis® Emerging Issues Analysis 6831 (Dec. 14, 2012), accessible at: <http://www.lexisnexis.com/community/taxlaw/blogs/emergingissues/archive/2012/12/20/u-s-fatca-information-reporting-fishing-for-forsaken-tax-revenues.aspx>.

3 See Staff of Joint Committee on Taxation, *Tax Compliance and Enforcement Issues With Respect to Offshore Accounts and Entities*, Scheduled for a Public Hearing Before the SUBCOMMITTEE ON SELECT REVENUE MEASURES of the HOUSE COMMITTEE ON WAYS AND MEANS on March 31, 2009 (JCX-23-09 March 30, 2009), accessible at: <https://www.jct.gov/publications.html?func=startdown&id=3520>.

4 *Id.*, at pp. 18-19, referencing Government Accountability Office, Report to the Committee on Finance, U.S. Senate, *Tax Compliance: Qualified Intermediary Program Provides Some Assurance that Taxes on Foreign Investors Are Withheld and Reported, but Can Be Improved* (GAO-08-99) (Dec. 2007), accessible at: <http://www.gao.gov/assets/280/270588.pdf>.

5 The "payee" is the person to whom a payment is made, regardless of whether such person is the beneficial owner of the amount". See Prop. Reg. Sec. 1.1471-3(a)(1).

6 See Staff of Joint Committee on Taxation, *Tax Compliance and Enforcement Issues With Respect to Offshore Accounts and Entities* supra, at p. 18 ("Withholding agents must certify that they have withheld the proper amount of tax, often with respect to very large volumes of income flows. Proper withholding, in turn, requires the withholding agent to determine whether a payee has U.S. or foreign status; whether a payee is the beneficial owner of the income or is an intermediary receiving a payment on behalf

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FATCA addresses these deficiencies by empowering the IRS to unilaterally deputize foreign financial institutions ("FFIs")⁷ to serve as the IRS' extraterritorial information reporting and withholding agents⁸ with respect to accounts held in the names of NFFEs for the benefit of their respective owners. Where a disclosure compliance agreement⁹ has been entered into between the IRS and an FFI, the FFI must generally assume the following obligations in order to avoid the imposition of a 30% withholding tax upon certain of its own U.S. source income:¹⁰ 1) to conduct due diligence necessary and sufficient to secure correct U.S. account¹¹ and account holder information; 2) to file related information reports; 3) to generally withhold a 30% tax from U.S. source "withholdable payments"¹² made directly to an NFFE or indirectly to U.S. account holders through¹³ NFFEs; and 4) to close U.S. accounts with respect to which the FFI has not been provided a waiver granting it a derogation from bank secrecy nondisclosure laws.¹⁴

of the owner; whether the payment can be reliably associated with proper documentation; and whether, in the absence of documentation, certain presumptions require full, reduced, or zero withholding or instead require backup withholding. Problems with withholding can result from errors related to any aspect of this self-certification process.").

7 See [26 USC 1471\(d\)\(4\)](#).

8 FATCA defines the term "withholding agent" to include "all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of any withholdable payment." See [26 USC 1473\(1\)\(C\)\(4\)](#).

9 See [26 USC 1471\(b\)\(1\)](#) and (e), 1474(e); Prop. Reg. 1.1471-4. Although the IRS has not yet released an FFI Agreement form, it has solicited public comments for purposes of formulating Draft Form 8957 - *Registration for Participating, Limited, or Registered Deemed Compliant Foreign Financial Institution Status*. See [77 FR 49060](#) (Aug. 15, 2012), accessible at: <http://www.gpo.gov/fdsys/pkg/FR-2012-08-15/pdf/2012-19972.pdf>.

10 See 156 CONG. REC. S1745, *supra*. See also [26 USC 1471\(a\)](#), (b)(3).

11 FATCA refers to these accounts as "United States Accounts", which are defined as "any financial account which is held by one or more specified United States persons or United States owned foreign entities." See [26 USC 1471\(d\)\(1\)\(A\)](#). A "Specified United States Person" is defined as including "United States Persons" *other than* publicly traded corporations, affiliated corporate group members, nonprofit organizations and certain individual retirement accounts, US federal governmental agencies and instrumentalities, US territories, State governments and subdivisions or tax-exempt trusts. See [26 USC 1473\(3\)](#). "United States Persons" include US citizens and residents, domestic partnerships, corporations and estates, and certain domestic and foreign trusts. See [26 USC 7701\(a\)\(30\)](#); Prop. Reg. 1.1471-1(b)(46)(i). A "United States-owned Foreign Entity" is defined as including "any foreign entity which has one or more substantial United States owners." See [26 USC 1471\(d\)\(3\)](#). A "Substantial United States Owner" is defined as including "Specified United States Persons" holding: a) a greater than 10% direct or indirect stock ownership interest (by vote or value) in a corporation; b) a greater than 10% direct or indirect equity or profits interest in a partnership; and c) any deemed interest in a tax-exempt trust, or a greater than 10% direct or indirect actual beneficial interest in such trust. See [26 USC 1473\(2\)](#).

12 FATCA defines the term "withholdable payment" to consist of all US source payments made to US citizens and residents, including payments of US source "fixed or determinable, annual or periodical" ("FDAP") made to nonresident aliens and foreign corporations that are subject to the more limited withholding rules of Subchapter 3 to Title A of the Internal Revenue Code. *Cf.* 26 USC 1473(1)(A) to [26 USC 1441-1442](#).

13 FATCA refers to these types of payments as "pass-thru payments", which are defined as "any withholdable payment or other payment to the extent attributable to a withholdable payment." See [26 USC 1471\(d\)\(7\)](#).

14 See [26 USC 1471\(a\)](#), (b)(3); [26 USC 1471\(d\)\(6\)](#).

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General Rule With Respect to NFFEs:

A participating FFI ("PFFI") or other withholding agent¹⁵ that has entered into an agreement with the IRS must deduct and withhold a 30% tax from any U.S. source "withholdable payment"¹⁶ made to an NFFE¹⁷ that is the beneficial owner of such payment or to some other NFFE,¹⁸ *if*: 1) such beneficial owner¹⁹ or the payee²⁰ fails to provide the PFFI with certain prescribed information;²¹ 2) the withholding agent knows or has reason to know²² that any provided information is incorrect;²³ or 3) the withholding agent fails to report such information to the U.S. Treasury Department in the

15 A "withholding agent" is "any person, U.S. or foreign, in whatever capacity acting, that has the control, receipt, custody, disposal, or payment of a withholdable payment." See Prop. Reg. Sections 1.1471-1(b)(68); 1.1473-1(d)(1).

16 "Withholdable payments" include payments of "fixed or determinable, annual or periodical" ("FDAP") income derived from U.S. sources and gross proceeds from the sale or other disposition of any property of a type which can produce U.S. source interest or dividends. See [26 USC 1473](#)(1)(A)-(B); Prop. Reg. Sec. 1.1473-1(a)(1). "[A] payment is derived from sources within the United States if it is income treated as derived from sources within the United States under sections 861 through 865 and other relevant provisions of the Code." See Prop. Reg. Sec. 1.1473-1(a)(2)(ii).

17 "In the case of a withholdable payment to an NFFE, a withholding agent is required to determine whether withholding applies under section 1472 and §1.1472-1." See Prop. Reg. Sec. 1.1471-2(a)(1).

18 See [26 USC 1472](#)(a).

19 "Except as provided in §1.1472,...[Prop. Reg. Sec. 1.1472-1(d) defines when a withholding agent may treat the beneficial owner of [a] payment as an NFFE]...the term beneficial owner has the meaning set forth in §1.1441-1(c)(6) (emphasis added)." See Prop. Reg. Sec. 1.1471-1(b)(5). [Treas. Reg. Sec. 1.1441-1\(c\)\(6\)](#) provides that, "The term beneficial owner means the person who is the owner of the income for tax purposes and who beneficially owns that income. A person shall be treated as the owner of the income to the extent that it is required under U.S. tax principles to include the amount paid in gross income under section 61...Thus, a person receiving income in a capacity as a nominee, agent, or custodian for another person is not the beneficial owner of the income."

20 "The term payee has the meaning set forth in §1.1471-3(a)...(i)...The term U.S. payee means any payee that is a U.S. person...(ii)...The term foreign payee means any payee other than a U.S. payee." See Prop. Reg. Sec. 1.1471-1(b)(44)(i)-(ii). "[F]or purposes of chapter 4 of the Internal Revenue Code[,] a payee is the person to whom a payment is made, regardless of whether such person is the beneficial owner of the amount." See Prop. Reg. Sec. 1.1471-3(a)(1). However, "For purposes of payments made to a financial account and except as otherwise provided in paragraph (a)(3) of this section, the payee is the holder of the financial account." See Prop. Reg. Sec. 1.1471-3(a)(2). For example, "A foreign person that the withholding agent may treat as acting as an agent or intermediary with respect to a payment...is not the payee if it is—(1) An NFFE..." See Prop. Reg. Sec. 1.1471-3(a)(3)(i)(A)(1). See also e.g., Prop. Reg. Sec. 1.1471-3(a)(ii)(A)(2) ("A foreign entity that a withholding agent may treat as a flow-through entity is not a payee with respect to a payment unless the flow-through entity is—... (2) An active NFFE or excepted FFI that is not acting as an agent or intermediary with respect to the payment...").

21 See [26 USC 1472](#)(b)(1).

22 See, e.g., Prop. Reg. Sec. 1.471-2(a)(2)(ii) and (a)(2)(iv) (providing that "A participating FFI that acts as an intermediary or that is a non-withholding flow-through entity and that provides a valid withholding certificate and all required documentation is not required to withhold or report such payment under chapter 4 *unless it knows or has reason to know* that the withholding agent failed to withhold the correct amount or failed to report the payment correctly") (emphasis added). See also Prop. Reg. Sec. 1.471-2(b)(2) (providing that "A withholding agent may rely upon a person's entity classification contained in a valid Form W-8 or Form W-9 if the withholding agent *has no reason to know* that the entity classification is incorrect", and that "A withholding agent that makes a payment with respect to an offshore obligation may also rely upon a written notification provided by the person who receives the payment, regardless of whether such notification is signed, that indicates the person's entity classification unless the withholding agent *has reason to know* that the entity classification indicated by the person who receives the payment is incorrect") (emphasis added). See also Prop. Reg. Sec. 1471-2(d)(1)-(11) (providing that "A withholding agent may not rely on documentation described in this paragraph (d) if it *knows or has reason to know* that such documentation is incorrect or unreliable" (emphasis added); Prop. Reg. Sec. 1471-2(e) (setting forth "the standards of knowledge for when a withholding agent *knows or has reason to know* that a withholding certificate is unreliable or incorrect" (emphasis added).

23 See [26 USC 1472](#)(b)(2).

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form prescribed.²⁴ Stated differently, “a withholding agent must withhold tax of 30 percent on any “withholdable payment” made to a payee that is an NFFE, *unless* [1] the beneficial owner of such payment is the NFFE or another NFFE; 2] the withholding agent can treat the beneficial owner as an NFFE that does not have any ‘substantial U.S. owners’ or as an NFFE that has identified its substantial U.S. owners[;] *and* [3] “the withholding agent reports the required information with respect to any substantial U.S. owners.”²⁵

An NFFE must provide the responsible PFFI or other withholding agent (e.g., a USFI) with the following information: 1) a certification that such beneficial owner does not have any “substantial United States owners” – i.e., it is exempt from FATCA;²⁶ or 2) the name, address, and TIN of each “substantial United States owner” of such beneficial owner.²⁷ FATCA defines “substantial United States owners” as encompassing “specified United States persons” (including U.S. citizens and residents, domestic partnerships, corporations and estates, and certain domestic and foreign trusts)²⁸ holding: a) a greater than 10% direct or indirect stock ownership interest (by vote or value) in a corporation; b) a greater than 10% direct or indirect equity or profits interest in a partnership; and c) any deemed interest in a tax-exempt trust, or a greater than 10% direct or indirect actual beneficial interest in such trust.²⁹ For example, even an NFFE serving as an intermediary for a privately held foreign family business structured as a corporation, partnership or trust in which U.S. resident foreign owners retain substantial economic interests bears the prima facie burden of demonstrating that such entities do not have (and did not previously have) any “substantial United States owners.”

Consequently, FATCA holds PFFIs and other withholding agents ultimately responsible for reporting such information to the IRS and withholding a 30% tax if appropriate; it does not impose direct IRS reporting or withholding obligations on NFFEs except in rare instances. For example, an NFFE will be treated as a “withholding agent” under FATCA where it is a grantor trust making a “withholdable payment” to a person that can be

24 See [26 USC 1472](#)(b)(3).

25 See Prop. Reg. Sec. 1.1472-1(b)(1)(i)-(iii).

26 See [26 USC 1472](#)(b)(1)(A).

27 See [26 USC 1472](#)(b)(1)(B).

28 See [26 USC 7701](#)(a)(30); Prop. Reg. 1.1471-1(b)(46)(i). “Specified United States Persons”, however, do not include “publicly traded corporations, affiliated corporate group members, nonprofit organizations and certain individual retirement accounts, US federal governmental agencies and instrumentalities, US territories, State governments and subdivisions thereof, or tax-exempt trusts.” See [26 USC 1473](#)(3).

29 See [26 USC 1473](#)(2).

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treated as the trust owner,³⁰ or with respect to certain withholdable payments that an NFFE makes to the true owner of a partnership interest for whom/which the NFFE acts as nominee.³¹ In addition, if an NFFE can be treated as an intermediary or flow-through entity with respect to a withholdable payment and another withholding agent has not withheld the full amount required, the NFFE will generally bear residual withholding responsibility.³²

NFFEs, otherwise, bear the fundamental burden of producing information about itself and their beneficial owners that is sufficient in terms of quality, quantity and form (burden of production and persuasion) to enable responsible PFFIs or other withholding agents to satisfy their FATCA (statutory and regulatory) obligations. For example, an FFI or USFI in which an NFFE holds a financial account or an investment interest³³ may call upon said NFFE to certify the U.S. or non-U.S. status of their direct or indirect owners for FATCA purposes or to certify the “ordinary course of business” or “effectively connected income” status of U.S. source payments received from non-account holders.

Exceptions to General FFI Obligation to Withhold From NFFE Payments:*Non-“Withholdable Payments”*

A PFFI or other withholding agent is not required to withhold a 30% tax on any U.S. source payment made to an NFFE that can be treated as other than a “withholdable payment.” An NFFE payment will be considered other than a “withholdable payment”

30 “The term withholding agent includes a grantor trust with respect to a withholdable payment... made to a person treated as an owner of the trust under sections 671 through 679.” See Prop. Reg. Sec. 1.1473-1(d)(3). Where a payment of U.S. source FDAP income is paid to a grantor trust, “a person treated as an owner of such trust is treated as having been paid such income by the trust at the time it is received by or credited to the trust.” See Prop. Reg. Sec. 1.1473-1(a)(5)(v).

31 “When several persons qualify as a withholding agent with respect to a single payment, only one tax is required to be withheld and deposited... A person who, as a nominee described in §1.6031(c)-1T, has furnished to a partnership all of the information required to be furnished under §1.6031(c)-1T(a) shall not be treated as a withholding agent if it has notified the partnership that it is treating the provision of information to the partnership as a discharge of its obligations as a withholding agent.” See Prop. Reg. Sec. §1.1473-1(d)(5). “Any person who holds, directly or indirectly, an interest in a partnership...as a nominee on behalf of another person at any time during the partnership taxable year shall furnish to the partnership a written statement (or statements) for that taxable year with respect to such other person containing the information described in paragraph(a)(1)(ii) of this section.” See Temp. Reg. Sec. §1.6031(c)-1T(a)(i). The nominee must provide information describing itself, the status of the true owner of the partnership interest, the partnership interest held by the nominee on behalf of the true owner and the nominee’s disposition of that interest during the current taxable year. See Temp. Reg. Sec. §1.6031(c)-1T(a)(ii). Conversely, if such nominee fails to provide the partnership with all of the required information, or otherwise provides all such information but fails to notify the partnership that it is treating the provision of such information as a discharge of its withholding agent obligation, it would be treated as a withholding agent with respect to such payment. See also [Treas. Reg. Sec. 1.1446-\(c\)\(2\)\(ii\)\(F\)](#); 1.1446-1(c)(2)(vi); 1.1446-4(b); 1.1446-4(d)-(e).

32 See Prop. Reg. Sec. 1.1471-2(2)(ii).

33 The term “financial account”, for purposes of Chapter 4, includes any “depository account” and “custodial account” maintained by a financial institution, as well as, certain non-publicly traded “equity or debt interests” in a financial institution. See Prop. Reg. Sec. 1.1471-5(b)(1)(i)-(iii).

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depending on the status of the payor or the nature of the payment, or depending on whether the NFFE payee qualifies as an “excepted NFFE” under one or more FATCA regulatory provisions.³⁴

FATCA proposed regulations exclude from the definition of “withholdable payment” any payment made to an NFFE that is attributable to income “effectively connected with a U.S. trade or business.”³⁵ “Generally, when a foreign person engages in a trade or business in the United States, all income from sources within the United States connected with the conduct of that trade or business is considered to be Effectively Connected Income (ECI). This applies whether or not there is any connection between the income and the trade or business being carried on in the United States, during the tax year...Deductions are allowed against ECI, and it is taxed at the graduated rates or lesser rate under a tax treaty.”³⁶

A payment made to an NFFE will also not be treated as a “withholdable payment” to the extent it is attributable to a withholding agent’s “ordinary course of business” payment – i.e., an arm’s-length payment made by a withholding agent “in the ordinary course of its business for nonfinancial services, goods, and the use of property.”³⁷ This exception anticipates that the withholding agent can be other than an FFI or USFI, and consequently, that an NFFE payee may or may not hold a financial account in the payor institution.³⁸ Ordinary course payments include those “for nonfinancial services, wages,

34 “A participating FFI must comply with the provisions set forth in §1.1471-4(b) and its FFI agreement to determine its withholding obligations under section 1472 and paragraph (b) of this section with respect to any withholding payment made to a payee that is an NFFE.” See Prop. Reg. Sec. §1.1472-1(b)(2).

35 See Prop. Reg. Sec. 1.1473-1(a)(4)(ii). However, if the beneficial owner claims an exception from tax under an income tax treaty because the income is not attributable to a US permanent establishment, it is likely to be considered a withholdable payment. *Id.* See also 26USC 871(b)(1); 882(a)(1).

36 See Internal Revenue Service, *Effectively Connected Income (ECI)*, accessible at: [http://www.irs.gov/Individuals/International-Taxpayers/Effectively-Connected-Income-\(ECI\)](http://www.irs.gov/Individuals/International-Taxpayers/Effectively-Connected-Income-(ECI)). “Whether you are engaged in a trade or business in the United States depends on the nature of your activities...[Y]ou are considered to be engaged in a trade or business in the United States...[i]f you are a member of a partnership that at any time during the tax year is engaged in a trade or business in the United States...when you perform personal services in the United States...with certain exceptions...[i]f you own and operate a business in the United States selling services, products, or merchandise...[if you sell] or exchange...U.S. real property interests...[or if you elect to treat] income from the rental of real property...as ECI.” *Id.*

37 See Prop. Reg. Sec. 1.1473-1(a)(4)(iii).

38 See Internal Revenue Service, *Notice 2010-60 - Notice and Request for Comments Regarding Implementation of Information Reporting and Withholding Under Chapter 4 of the Code*, [2010-37 IRB 329, 344](http://www.irs.gov/pub/irs-irbs/irb10-37.pdf) (Sept. 13, 2010) accessible at: <http://www.irs.gov/pub/irs-irbs/irb10-37.pdf>; <http://www.irs.gov/pub/irs-drop/n-10-60.pdf>. (“Treasury and the IRS contemplate permitting U.S. withholding agents other than USFIs to rely on a foreign entity’s certification as to its classification for chapter 4 purposes, absent reason to know that such certification is unreliable or incorrect. These requirements would also apply with respect to withholdable payments made by FFIs and USFIs to NFFEs that are not holders of financial accounts maintained by the financial institution. Treasury and IRS request comments on the form of such certifications, their renewal provisions, and circumstances under which a withholding agent should not be required to solicit such certifications from certain classes of persons or with respect to certain classes of payments, such as arm’s-length payments made for goods or services in the ordinary course of the withholding agent’s trade or business”) (emphasis added). *Id.*

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office and equipment leases, software licenses, transportation, freight, gambling winnings, awards, prizes, scholarships, and interest on outstanding accounts payable arising from the acquisition of nonfinancial services, goods, and other tangible property."³⁹ The proposed regulations do not appear to address all licenses, as they do not currently include licenses relating to the acquisition of valuable intangible assets, such as patents, trade secrets, trademarks, copyrights, etc. It may be anticipated that the Treasury Department will address this oversight in the final regulations in order not to adversely impact companies operating in the technology, media and entertainment sectors. In addition, it may be anticipated that final regulations will also identify the types of equipment leases included within this exception – i.e., whether they can consist of financial and capital leases as well as operating leases, and personal as well as office equipment leases.

Furthermore, FATCA does not treat as a “withholdable payment” any payment of interest or original issue discount on short-term obligations,⁴⁰ gross proceeds from the sale or other disposition of any property that can produce U.S. source fixed, determinable, annual or periodic (“FDAP”) income falling within the previous three exceptions,⁴¹ or any payment made from sales of fractional shares of such property.⁴²

Otherwise Withholdable Payments Made to Certain “Excepted” NFFEs

Otherwise withholdable payments which a withholding agent may treat as beneficially owned by an “excepted NFFE”⁴³ are exempt from 30% withholding. These include payments beneficially owned by: 1) a publicly traded corporation;⁴⁴ 2) a corporate affiliate of a publicly traded corporation;⁴⁵ 3) a “territory entity”⁴⁶ organized under the laws of a U.S. Possession and owned by one or more bona fide residents thereof;⁴⁷ and 4) certain “exempt beneficial owners”,⁴⁸ including: a) foreign governments or political subdivisions or wholly owned agencies or instrumentalities thereof;⁴⁹ b)

39 See Prop. Reg. Sec. 1.1473-1(a)(4)(iii).

40 See Prop. Reg. Sec. 1.1473-1(a)(4)(i).

41 See Prop. Reg. Sec. 1.1473-1(a)(4)(iv).

42 See Prop. Reg. Sec. 1.1473-1(a)(4)(v).

43 See Prop. Reg. Sec. 1.1472-1(c)(1). See also [26 USC 1472\(c\)\(1\)](#) (concerning exemptions available for “other classes of persons identified by the Secretary”).

44 See Prop. Reg. Sec. 1.1472-1(c)(1)(i).

45 This exception applies to a corporation that is a member of the same expanded affiliated group as the publicly traded corporation. See Prop. Reg. Sec. 1.1472-1(c)(1)(ii).

46 See Prop. Reg. Sec. 1.1471-1(b)(58).

47 See Prop. Reg. Sec. 1.1472-1(c)(1)(iii).

48 See Prop. Reg. Sec. 1.1472-1(c)(1)(iv). An ‘exempt beneficial owner’ is defined as including any person described in §1.1471-6(b) through (g). See Prop. Reg. Sec. 1.1471-1(b)(19).

49 See Prop. Reg. Sec. 1.1471-6(b).

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international organizations or wholly owned agencies or instrumentalities thereof;⁵⁰ c) foreign central banks;⁵¹ d) governments of U.S. Possessions;⁵² e) certain retirement funds;⁵³ and f) entities wholly owned by exempt beneficial owners.⁵⁴

In addition, otherwise withholdable payments made to an NFFE payee that a withholding agent may treat as a withholding foreign partnership ("WP")⁵⁵ or a withholding foreign trust ("WT")⁵⁶ with respect to distributive share income amounts subject to nonresident alien ("NRA") withholding under [IRC subchapter 3](#)⁵⁷ are excepted from the general FATCA 30% withholding requirement.⁵⁸

Furthermore, otherwise withholdable payments presumed to pose a low risk of tax evasion are "excepted" from 30% withholding.⁵⁹ Such payments include those made to an NFFE that is an "active" NFFE.⁶⁰ The proposed regulations provide that an NFFE will be considered to be "active" if less than 50 percent of its preceding calendar year's (or other appropriate reporting period's)⁶¹ gross income was passive income,⁶² or if less

50 See Prop. Reg. Sec. 1.1471-6(c).

51 See Prop. Reg. Sec. 1.1471-6(d).

52 See Prop. Reg. Sec. 1.1471-6(e).

53 See Prop. Reg. Sec. 1.1471-6(f).

54 See Prop. Reg. Sec. 1.1471-6(g). These include FFIs engaged in the business of investing, reinvesting, or trading in securities, partnership interests, commodities, insurance or annuity contracts or any interest therein within the meaning of 1471-5(e)(1)(iii), that are wholly owned by foreign governments and political subdivisions or wholly owned agencies and instrumentalities thereof, international organizations or wholly owned agencies or instrumentalities thereof, or foreign central banks.

55 "A 'withholding foreign partnership' is a person, described in [Treas. Reg. § 1.1441-5\(c\)\(2\)](#), that has entered into a withholding agreement with the IRS to be treated as a withholding foreign partnership and is acting in its capacity as a withholding foreign partnership." See Internal Revenue Service, [Rev. Proc. 2003-64 \(IRB 2003-32\)](#) (Aug. 11, 2003) at Appendix I, Sec. 2.28, accessible at: http://www.irs.gov/irb/2003-32_IRB/ar19.html#d0e2418.

56 "A 'withholding foreign trust' is a person, described in [Treas. Reg. § 1.1441-5\(e\)\(v\)](#), that has entered into a withholding agreement with the IRS to be treated as a withholding foreign trust and is acting in its capacity as a withholding foreign trust." *Id.*, at Appendix II, Sec. 2.29.

57 "A WP or WT may act in that capacity only for payments of amounts subject to NRA withholding that are distributed to, or included in the distributive share of, its direct partners, beneficiaries, or owners. A WP or WT acting in that capacity must assume NRA withholding responsibility for these amounts...[A] WP or WT...[may be treated]...as a payee if it has provided...documentation...that represents that it is acting as a WP or WT for such amounts." See Internal Revenue Service, [Withholding Foreign Partnership and Foreign Trust](#), accessible at: <http://www.irs.gov/Individuals/International-Taxpayers/Withholding-Foreign-Partnership-and-Foreign-Trust>.

58 See Prop. Reg. Sec. 1.1472-1(c)(2).

59 See [26 USC 1472\(c\)\(2\)](#).

60 See Prop. Reg. Sec. 1.1472-1(c)(1)(v).

61 While the proposed regulations clarify that the statute's reference to gross income for the calendar year concerns the "previous" calendar year, the Treasury Department's Model Intergovernmental Agreements broaden this language to include "the preceding calendar year or other appropriate reporting period". See Internal Revenue Service, [Reciprocal Version of Model Agreement \(Model 1A\)](#) (hereinafter referred to as "Model 1A IGA") at Article VI.B.4(a), accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1A-Agreement-to-Implement-Reciprocal-11-14-2012.pdf>; Internal Revenue Service, [Nonreciprocal Version of Model Agreement \(Model 1B\)](#) (hereinafter referred to as "Model 1B IGA") at Article VI.B.4(a), accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-1B-Agreement-to-Implement-Nonreciprocal-11-14-2012.pdf>; Internal Revenue Service, [Agreement Between the United States of America and \[FATCA Partner\] for Cooperation to Facilitate the Implementation of FATCA – Model 2 Template](#) (hereinafter referred to as

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than 50 percent of the assets it held at any time during the preceding calendar year (or other appropriate reporting period)⁶³ “are assets that produced or are held for the production of dividends, interest, rents and royalties (other than rents and royalties derived in the active conduct of a trade or business conducted by employees of the NFFE), annuities, or other passive income.”⁶⁴ Perhaps, in defining this rent and royalty exception, final Treasury regulations will reference the language used in the exception to “foreign personal holding company income” contained in Section 954(c)(2)(A) and accompanying regulations of Subpart F of the Code (“rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person”).⁶⁵ More significantly, perhaps final Treasury regulations will also feature the much expanded definition of “active NFFE” contained in Article VI.B.4 of each of the Treasury Department’s Model Intergovernmental Agreements (“IGAs”). It not only includes an entity that meets a more restrictive conjunctive income and asset test,⁶⁶ but also encompasses any other entities that qualify as “excepted NFFEs”, including “exempt beneficial owners”, as well as, “excluded FFIs” that are treated as NFFEs.⁶⁷

“Model 2 IGA”) at Article VI.B.4(a), accessible at: <http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Model-2-Agreement-to-Implement-11-14-2012.pdf>.

62 *Id.*63 *Id.*

64 In addition to dividends, interest, rents and non-business-related royalties, the proposed regulations clarify that “other passive income” includes life insurance contract death benefits; pooled insurance contract receipts; invested net property sales or exchange gains giving rise to interest, rents, royalties or insurance benefits; net commodities trading gains (other than hedge trades); net foreign currency exchange gains; and net income from notional principal contracts. See Prop. Reg. Sec. 1.1472-1(c)(1)(v)(A)-(J).

65 See [26 USC 954](#)(c)(2)(A). Accompanying regulations provide that “rents will be considered...to be derived in the active conduct of a trade or business if such rents are derived...from leasing...[r]eal property with respect to which the lessor, through its own officers or staff of employees, regularly performs active and *substantial* management and operational functions while the property is leased; [and from] [p]roperty that is leased as a result of the performance of marketing functions by such lessor if the lessor, through its own officers or staff of employees located in a foreign country, maintains and operates an organization in such country that is regularly engaged in the business of marketing, or of marketing and servicing, the leased property and that is substantial in relation to the amount of rents derived from the leasing of such property” (emphasis added). See [Treas. Reg. Sec. 1.954-2\(c\)\(1\)\(ii\)](#) and (iv). These regulations also provide that “[r]oyalties will be considered...to be derived in the active conduct of a trade or business if such royalties are derived...from licensing...[p]roperty that is licensed as a result of the performance of marketing functions by such licensor if the licensor, through its own officers or staff of employees located in a foreign country, maintains and operates an organization in such country that is regularly engaged in the business of marketing, or of marketing and servicing, the licensed property and that is *substantial* in relation to the amount of royalties derived from the licensing of such property” (emphasis added). See [Treas. Reg. Sec. 1.954-2\(d\)\(1\)\(ii\)](#). See also [Treas. Reg. Sections 1.954-2\(c\)\(2\)\(ii\)](#) and [1.954-2\(d\)\(2\)\(ii\)](#) (providing safe harbor rules to determine whether an organization in a foreign country is “substantial” in relation to the amount of rents and royalties derived from the licensing of such property).

66 See Article VI.B.4 of the Model 1A IGA, Model 1B IGA and Model 2 IGA, *supra*. As noted above, the proposed regulations utilize a more permissive disjunctive income and asset test to determine “active NFFE” status.

67 See Article VI.B.4(a)-(i) of the Model 1A IGA, Model 1B IGA and Model 2 IGA *supra*, which generally provide that an NFFE shall be treated as an “active NFFE” if it qualifies as any one of the following: 1) a publicly traded corporation or an affiliate of a publicly traded corporation; 2) a territory entity; 3) a governmental entity or foreign central bank or a wholly owned entity thereof; 4) a foreign nonfinancial holding company; 5) a foreign start-up; 6) a foreign nonfinancial entity in the process of liquidating or reorganizing; 7) a foreign entity that primarily engages in financing and hedging transactions with or for its expanded affiliated group members that are not financial institutions.

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The proposed regulations provide, however, that where an NFFE does not qualify as an “excepted” NFFE that is a publicly traded corporation, a corporate affiliate of a publicly traded corporation, a territory entity, an active NFFE, an exempt beneficial owner, or a WP or WT, it will be treated as a “passive NFFE” that is potentially subject to chapter 4 withholding, unless it otherwise qualifies as an “excepted NFFE”.⁶⁸ It may be anticipated that final Treasury regulations will also define a “passive NFFE” as including an entity that does not qualify as an “excluded FFI” to maintain consistency with the corresponding IGA provisions noted above.

Moreover, the proposed regulations provide that otherwise withholdable payments made to an entity that is excluded from the definition of an FFI and treated as an “excepted NFFE” are not subject to 30% withholding.⁶⁹ Such payee entities include: a) foreign nonfinancial holding companies substantially all of the activities of which consist of owning all or part of the outstanding stock of one or more subsidiaries that engage in trades or businesses other than as financial institutions;⁷⁰ b) foreign start-ups lacking both an operating business and an operating history, that invest capital assets with the intent of operating a business other than that of a financial institution;⁷¹ c) foreign nonfinancial entities in the process of liquidating assets or reorganizing to continue or commence operations as a nonfinancial entity;⁷² d) a foreign entity that primarily engages in financing and hedging transactions with or for its expanded affiliated group members that are not financial institutions, and that does not render such services to non-affiliates, but only if the expanded affiliated group’s primary trade or business is other than acting as a financial institution;⁷³ and e) a charitable nonprofit organization satisfying the requirements of [IRC Section 501\(c\)](#).⁷⁴

It may be anticipated that final regulations will further define the term “foreign nonfinancial holding company” to help foreign entities determine whether they qualify for the “excepted FFI” designation. For example, Treasury received comments in response to the proposed regulations seeking clarification concerning whether a minimum

68 See Prop. Reg. Sections 1.1471-1(b)(36)(ii)-(iii); 1.1472-1(c)(1) and (2).

69 See Prop. Reg. Sec. 1.1472-1(c)(1)(vi).

70 See Prop. Reg. Sec. 1.1471-5(e)(5)(i).

71 See Prop. Reg. Sec. 1.1471-5(e)(5)(ii). This exception is available only during the first 24 months of an entity’s formation. An entity that functions (or holds itself out) as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund, or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purpose, does not qualify as an excepted NFFE. *Id.*

72 See Prop. Reg. Sec. 1.1471-5(e)(5)(iii). An entity must have been a nonfinancial entity for a period of five years prior to its liquidation or reorganization. *Id.*

73 See Prop. Reg. Sec. 1.1471-5(e)(5)(iv).

74 See Prop. Reg. Sec. 1.1471-5(e)(5)(v).

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subsidiary partial ownership threshold and specific constructive ownership rules would apply,⁷⁵ as well as, concerning whether a minimum specific “substantial activity” threshold or a more flexible “primary purpose” test would apply.⁷⁶ In addition, Treasury received comments seeking clarification concerning whether: 1) a “safe harbor” would be provided for certain types of “financing and hedging activities” in which a foreign entity would be permitted to engage with or for its expanded affiliated group (EAG) members;⁷⁷ 2) a minimum (“no more than”) EAG gross income threshold would apply with respect to the “primarily engaged in a trade or business other than that of a financial institution” requirement;⁷⁸ and a de minimis “safe harbor” would be provided for certain limited financing and hedging transactions in which a foreign entity could engage with non-affiliates in the ordinary course of its business.⁷⁹

75 “[I]t is unclear what role the parenthetical phrase ‘in whole or in part’ plays in the definition of a holding company, if such a company must own stock in a subsidiary (however defined). If the phrase is intended to engraft a constructive ownership or similar concept, such that the holding company’s stock ownership is to be combined with other ownership within the holding company’s [expanded affiliated group] EAG, then...such a rule should be stated clearly, for example by a reference to the constructive ownership rules of section 318.” See Tax Executives Institute, Inc., *Comments on Proposed Regulations relating to The Foreign Account Tax Compliance Act (FATCA) IRS REG-121647-1* (April 30, 2012) at p. 17, accessible at: <http://www.tei.org/news/Documents/TEI%20Comments%20on%20FATCA%20Proposed%20Regulations%20IRS%20REG-121647-10.pdf>.

76 “[T]he definition of holding company begins with the phrase ‘substantially all of the activities of which is to own’ subsidiary stock, but no guidance is provided with respect to the scope of this term...The vagueness of this definition is particularly problematic because a foreign holding company that fails to qualify for the exception will be an FFI and therefore be subject to full FATCA reporting and withholding requirements...[T]he definition of a holding company [should] either provide an objective test for determining whether the holding company qualifies for the exception (e.g., that 80 percent or more of the holding company’s income be derived from dividends from members of its EAG and income from acting as a financing affiliate for its non-financial EAG) or revert to the ‘primary purpose’ test set forth in [Notice 2010-60](#), thereby providing a more flexible standard.” *Id.*, at pp. 17-18.

77 “TEI recommends that the regulations be revised to provide that *an entity primarily engaged in one or more of the following non-exclusive list of activities with or for members of its EAG will be considered a financing affiliate as long as the EAG is ‘primarily engaged in a business other than that of a financial institution’* as defined in the proposed regulations: (i) Borrowing money from, lending money to, or purchasing securities from, EAG members; (ii) Raising funds from related or unrelated parties and transferring funds to EAG members; (iii) Providing hedging functions (including hedging foreign exchange, raw material, commodity, and other business risks, regardless whether a hedge is designated a hedge for tax purposes), cash management activities (including long- and short-term credit or credit and collections), or other Treasury functions to EAG members; (iv) Receiving deposits from EAG members that have excess available cash and investing the cash from such deposits in an investment portfolio; (v) Netting intercompany receivables and intercompany payables of EAG members; (vi) Providing loans to EAG members that require working capital or other short term funding; (vii) Entering into derivative contracts to hedge currency exposure; and (viii) Entering into other notional principal contracts (such as interest rate swaps) to hedge other risks” (emphasis added). *Id.*, at pp. 13-14.

78 “TEI also recommends that final regulations adopt a definition of what it means for an EAG to be ‘primarily engaged in a business’ other than that of a financial institution for purposes of the financing affiliate exception. Specifically, TEI recommends that if less than 50 percent of an EAG’s gross income is attributable to a business described in Prop. Reg. § 1.1471-5(e)(1) (that is, the definition of a financial institution) over the shorter of (i) the three-year period ending on December 31 of the year in which the determination is made, or (ii) the period during which the EAG has been in existence, then the EAG should not be considered —primarily engaged in a financial institution business. Further, for purposes of determining such a threshold, the income of any entity described in Prop. Reg. § 1.1471-5(e)(5), which includes the exceptions for a holding company and a financing affiliate (among other things), should be excluded.” *Id.*, at p. 14.

79 “...TEI recommends that the definition of a financing affiliate be modified to allow such an entity to engage in limited transactions with unaffiliated persons as part of the ordinary course of its business. For example, a financing affiliate may make a loan to a customer as part of a long-term relationship building effort, which may run afoul of the regulatory prohibition of providing financing services to non-affiliates. Further, some financing affiliates may engage in transactions with unrelated parties to demonstrate that

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Lawrence A. Kogan on

FATCA Imposes Not-So-Insubstantial Burdens on Non-Financial Foreign Entities ("NFFEs") - Some Examples**Documentary Evidence Required to Substantiate Chapter 4 Payee/Intermediary"/"Flow-Through Entity" Status, "Non-Withholdable Payment" Status, and "Excepted NFFE" Status:***Reliable and Valid Evidence*

FATCA effectively imposes a tiered withholding and reporting framework on PFFIs and other withholding agents that effectively requires an NFFE to disclose to such parties information about itself, its beneficial owners, and about other NFFEs in which it may hold beneficial interests. A PFFI or other withholding agent must be able to "reliably associate" a withholdable payment⁸⁰ or a payee's status with valid documentation,⁸¹ in order to determine for FATCA withholding purposes whether a payment made to an NFFE qualifies as a withholdable payment or whether an NFFE qualifies as an "excepted NFFE."⁸² "A withholding agent may rely on information and certifications contained in withholding certificates or other documentation without having to inquire into the truthfulness of the information or certifications,⁸³ unless it knows or has reason to know that the information or certifications are untrue."⁸⁴ In the absence of valid documentation, however, a withholding agent may employ one or more rebuttable regulatory presumptions regarding payee status to arrive at its determination.⁸⁵

the affiliate's transactions with related parties satisfy the arm's-length transfer pricing standard. Thus, we recommend that the exception for financing affiliates be framed to permit affiliates to perform such services for unrelated parties as long as such services are de minimis when compared with the services provided to the financing affiliate's EAG." *Id.*, at p. 15.

80 A withholdable payment may be reasonably associated with valid documentation if the withholding agent "holds valid documentation appropriate to the payee's chapter 4 status...prior to the payment...can reliably determine how much of the payment relates to the valid documentation, and...does not know or have reason to know that any of the information, certifications, or statements in, or associated with, the documentation are unreliable or incorrect." See Prop. Reg. Sec. 1.1471-3(c)(1).

81 At a minimum, a withholding agent must obtain a valid withholding certificate or a Form W-9 from a payee in order to treat said payee as having a particular chapter 4 status. Additional documentation may also be required in order to treat a payee as having a specific chapter 4 status. See Prop. Reg. Sec. 1.1471-3(d).

82 "[A] withholding agent may treat a withholdable payment as beneficially owned by an excepted NFFE if the withholding agent can reliably associate the payment with valid documentation to determine the payee's status as an excepted NFFE." See Prop. Sec. 1.1472-1(d)(1). "A withholding agent may treat the beneficial owner of a withholdable payment as an NFFE that does not have any substantial U.S. owners or that has identified all of its substantial U.S. owners if it can reliably associate the payment with valid documentation identifying the beneficial owner as an NFFE that does not have any substantial U.S. owners or that has identified all of its substantial U.S. owners". See Prop. Reg. Sec. 1.1472-1(d)(4).

83 "In cases where documentary evidence alone is not sufficient to establish that a payee with respect to an offshore obligation has a particular chapter 4 status, the withholding agent may supplement the documentary evidence with a written statement signed by the payee (or a person with authority to sign for the payee) under penalties of perjury that indicates that the payee meets the requirements to qualify for a particular chapter 4 status." See Prop. Reg. Sec. 1.1471-3(d).

84 See Prop. Reg. Sec. 1.1471-3(c)(1). "A withholding agent may not rely on documentation described in this paragraph (d) if it knows or has reason to know that such documentation is incorrect or unreliable". See Prop. Reg. Sec. 1.1471-3(d).

85 See Prop. Reg. Sec. 1.1471-3(f)(1) and (f)(7). These presumptions include "[p]resumptions of classification as an individual or entity", "[p]resumptions of U.S. or foreign status", "[p]resumption of chapter 4 status for a foreign entity", "[p]resumption of status as an intermediary", and presumption associated with "[j]oint payees". See Prop. Reg. Sec. 1.1471-3(f)(2)-6).

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The burden of producing documentation sufficient to facilitate these determinations falls primarily upon the NFFE. For example, an NFFE must be able to validate its bonafide status as "payee", "intermediary", or "flow-through entity"⁸⁶ with respect to a given payment or course of payments. Where an NFFE presents documentary evidence verifying that it serves in the capacity of an intermediary (nominee, agent or custodian)⁸⁷ with respect to a payment,⁸⁸ it will not be treated by a PFFI or withholding agent as the payee.⁸⁹ Similarly, where a foreign flow-through entity presents documentary evidence verifying that it is an "active NFFE" or "excepted FFI" acting in the capacity of an agent or intermediary with respect to a payment, it will not be treated by a PFFI or withholding agent as the payee.⁹⁰ Thereafter, the NFFE must be able to identify via valid documentation each of the legal persons for whom it collects a payment,⁹¹ including other NFFEs, which can be established by presentation of valid beneficial owner withholding certificates (i.e., IRS Forms W-9,⁹² W-8BEN⁹³ or W-8BEN-E).⁹⁴

86 A flow-through entity is defined as a partnership, simple trust, or grantor trust, as determined under U.S. tax principles. See Prop. Reg. Sec. 1.1471-1(b)(28). See also Internal Revenue Service, *Instructions for Form 1042-S (2013) - Foreign Person's U.S. Source Income Subject to Withholding, General Instructions*, accessible at: <http://www.irs.gov/instructions/i1042s/index.html>; <http://www.irs.gov/pub/irs-pdf/i1042s.pdf>. "A flow-through entity is a foreign partnership (other than a withholding foreign partnership), a foreign simple or grantor trust (other than a withholding foreign trust), or, for any payments for which a reduced rate of withholding under an income tax treaty is claimed, any entity to the extent the entity is considered to be fiscally transparent under section 894 with respect to the payment by an interest holder's jurisdiction." *Id.*

87 "A person is not a beneficial owner of Income...to the extent that person is receiving the income as a nominee, agent, or a custodian, or to the extent that the person is a conduit whose participation in a transaction is disregarded. Foreign partnerships, foreign simple trusts, and foreign grantor trusts are not the beneficial owners of income paid to the partnership or trust. The beneficial owner of income paid to a foreign estate is the estate itself. See [Treas. Reg. sec. 1.1441-1\(c\)\(6\)](#)." "An intermediary means, with respect to a payment that it receives, a person that, for that payment, acts as a custodian, broker, nominee, or otherwise as an agent for another person, regardless of whether such other person is the beneficial owner of the amount paid, a flow-through entity, or another intermediary." See [Treas. Reg. Sec. 1.1441-1\(c\)\(13\)](#).

88 "[A] withholding agent must base its determination of the chapter 4 status of a payee on documentation that the withholding agent can reliably associate with such payment." See Prop. Reg. Sec. 1.1471-3(b). "A withholding agent may treat the person who receives a payment as an intermediary if it can reliably associate the payment with a valid intermediary withholding certificate on which the person who receives the payment claims to be a [Qualified Intermediary] QI or [Non-Qualified Intermediary] NQI...[or]...with documentation that would be sufficient to treat the person as an excepted FFI...or otherwise as an NFFE if the person were the payee, and the person has provided written notification, whether or not such notification is signed, that it accepts the payment on behalf of another person or persons" (emphasis added). See Prop. Reg. Sec. 1.1471-3(b)(1).

89 An NFFE that a withholding agent can treat as an agent or intermediary with respect to a payment is not a payee. See Prop. Reg. Sec. 1.1471-3(a)(3)(i)(A).

90 "A foreign entity that a withholding agent may treat as a flow-through entity is *not* a payee with respect to a payment *unless* the flow-through entity is... (2) An active NFFE or excepted FFI that is not acting as an agent or intermediary with respect to the payment" (emphasis added). See Prop. Reg. Sec. 1.1471-3(a)(3)(ii)(A)(2).

91 In such case, the payee will be the "person or persons for whom the NFFE collects the payment". See Prop. Reg. Sec. 1.1471-3(a)(3)(i)(B).

92 See Prop. Reg. Sec. 1.1471-3(c)(3)(i). U.S. persons, including U.S. resident aliens, use Form W-9 to certify that their TINs are correct or that they are not subject to backup withholding, to claim exemption from backup withholding if they are U.S. exempt payees, or to certify that their allocable share of partnership income from a U.S. trade or business is not subject to the withholding tax on foreign partners' share of effectively connected income. See IRS Form W-9.

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“A withholding agent may treat the payee of a withholdable payment as an NFFE that is a WP or WT if the withholding agent can reliably associate the payment with valid documentation to determine the payee’s status.”⁹⁵ Conversely, a withholding agent may treat a partner or beneficiary of an NFFE that is a non-withholding foreign partnership (“NWP”) or non-withholding foreign trust (“NWT”) “as the payee of a withholdable payment...if the withholding agent can reliably associate the payment with a valid Form W-8 or written notification that the NFFE is a flow-through entity [that] include[s] valid documentation sufficient to establish the chapter 4 status of each payee of the payment that is a partner or beneficiary.”⁹⁶ An NFFE may establish for a withholding agent its own status as a WP, or WT (intermediary or payee), or validate whether a payment it has made to a U.S. person was received by a WP or WT, if the payment can be reliably associated with a valid Form W-8IMY. Such form must indicate that the payment recipient (itself or another payee) is a WP, or WT, and must also contain the recipient’s WP-EIN or WT-EIN.⁹⁷

An NFFE may establish its flow-through or intermediary status by providing the withholding agent not only with documentation confirming each payee’s Chapter 4 status,⁹⁸ but also with a valid intermediary or flow-through entity withholding certificate furnished on IRS Form W-8IMY⁹⁹ that includes a withholding statement made under penalties of perjury.¹⁰⁰ Alternatively, it may provide equivalent documentation consisting

93 See Prop. Reg. Sec. 1.1471-3(c)(3)(ii). All kinds of foreign beneficial owners of US source income have utilized IRS Form W-8BEN to certify their status as foreign and, if applicable, to claim a reduced treaty-based withholding rate. IRS Form W-8BEN, however, was recently modified to be used only by foreign individuals. See Draft Form W-8BEN - *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding (Individual)* (Dec. 2012), accessible at: <http://www.irs.gov/pub/irs-dft/fw8ben--dft.pdf>.

94 During June 2012, the IRS released new Form W-8BEN-E for entities given the many new withholding categories that Chapter 4 established for foreign entities. See Angela Offerman, *IRS Releases Draft of Form W-8BEN with FATCA Changes* (June 7, 2012), accessible at: <http://www.convey.com/2012/06/irs-releases-draft-of-form-w-8ben-with-fatca-changes/#axzz2GJHA16fl>. See also Draft Form W-8BEN-E, Part I, Line 4, accessible at: <http://www.irs.gov/pub/irs-utl/formw8benentityexeccirculation2.pdf>.

95 See Prop. Reg. Sec. 1.1472-1(d)(2).

96 See Prop. Reg. Sec. 1.1472-1(d)(3).

97 See Prop. Reg. Sec. 1.1471-3(b)(3).

98 See Prop. Reg. Sec. 1.1471-3(d).

99 “A withholding agent that makes a payment to a foreign intermediary or flow-through entity that is not the payee...can reliably associate the payment with valid documentation only if, in addition to...[documentation establishing the payee’s Chap. 4 status]...the withholding agent also has obtained a valid Form W-8IMY...from the intermediary or flow-through entity.” See Prop. Reg. Sec. 1.1471-3(c)(2)(i). “A withholding certificate of an intermediary, flow-through entity, or U.S. branch is valid for purposes of chapter 4 of the Internal Revenue Code only if it is furnished on a Form W-8IMY...” See Prop. Reg. Sec. 1.1471-3(c)(iii)(A). See also Internal Revenue Service, *Form W-8IMY - Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding*, accessible at: <http://www.irs.gov/pub/irs-dft/fw8imy--dft.pdf>.

100 “A withholding statement forms an integral part of the withholding certificate and the penalties of perjury statement provided on the withholding certificate apply to the withholding statement as well. The withholding statement may be provided in any manner, and in any form, to which the FFI, NFFE, or QI submitting the form and the withholding agent mutually agree”. See Prop. Reg. Sec. 1.1471-3(c)(2)(iii)(B); Instructions to Form W-8IMY - *Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or*

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of a notification of intermediary or flow-through status supplemented by a withholding statement disclosing each of the payees and the amounts appropriately allocable to them.¹⁰¹

At a minimum, an NFFE's withholding statement must contain "the name, address, TIN (if any), entity type, and chapter 4 status of each payee, the amount allocated to each payee, [and] a valid withholding certificate or other appropriate documentation sufficient to establish the chapter 4 status of each payee",¹⁰² except where "pooled" allocation information is permitted.¹⁰³ In addition, an NFFE's withholding statement must also provide "any other information reasonably necessary" to enable the withholding agent to report each payment in satisfaction of both its chapter 3 and 4 obligations.¹⁰⁴ A withholding agent may rely upon an NFFE's chapter 3 withholding statement so long as it includes all of the above information and specifies the respective portion of each payment withheld under chapters 3 and 4.¹⁰⁵ The withholding agent will report such information on modified information return IRS Form 1042-S¹⁰⁶ which it shall file for, and contain information about, each type of payment¹⁰⁷ made to each recipient¹⁰⁸ NFFE¹⁰⁹

Certain U.S. Branches for United States Tax Withholding (Rev. February 2006), accessible at: <http://www.irs.gov/pub/irs-pdf/iw8imy.pdf> (applicable with respect to chapter 3 of the Code).

101 "[A] withholding agent that makes a payment with respect to an offshore obligation to an intermediary or flow-through entity that is an NFFE, may rely upon a written notification from the intermediary or flow-through entity, regardless of whether such notification is signed, stating that the NFFE is a flow-through entity or is acting as an intermediary with respect to the payment, in lieu of the Form W-8", as long as "the NFFE intermediary or flow-through entity... provide[s] the withholding statement that generally accompanies the Form W-8IMY, designating the payees and the appropriate amount that should be allocated to each payee." See Prop. Reg. Sec. 1.1471-3(c)(2)(ii).

102 See Prop. Reg. Sec. 1.1471-3(c)(3)(iii)(B)(3).

103 However, "an NFFE is permitted to provide pooled allocation information with respect to payees that are treated as nonparticipating FFIs." *Id.*

104 See Prop. Reg. Sec. 1.1471-3(c)(3)(iii)(B)(3). "An NFFE withholding statement must contain...any other information reasonably necessary to enable the withholding agent to report the payment in accordance with the requirements described in §1.1474-1(d) and the requirements of Form 1042-S and the accompanying instructions." *Id.* "Paragraph (d)(1) prescribes the requirements for the filing of information returns by withholding agents to report payments subject to reporting for chapter 4 purposes and the recipients required to be reported on those forms. The IRS anticipates that such returns will be filed on Forms 1042-S, Foreign Person's U.S. Source Income Subject to Withholding." See Prop. Reg. Sec. 1.1474-1 Preamble, Sec. X.

105 See Prop. Reg. Sec. 1.1471-3(c)(3)(iii)(B)(3).

106 "[T]he IRS intends to modify the current Form 1042-S used by withholding agents for chapter 3 purposes to meet the additional reporting requirements of chapter 4 and to coordinate reporting in cases in which withholding under both chapters applies to a payment." See Prop. Reg. Sec. 1.1474-1 Preamble, Sec. X. Form 1042-S is used to report FDAP and other income from U.S. sources paid to a foreign person that is subject to 30% withholding, "even if no amount is deducted and withheld from the payment because of a tax treaty or IRC exception to taxation ...including the exemption for income that is effectively connected with the conduct of a trade or business in the United States...or if any amount withheld was repaid to the payee". See Internal Revenue Service, *Amounts Subject to Reporting on Form 1042-S*, accessible at: <http://www.irs.gov/Individuals/International-Taxpayers/Amounts-Subject-to-Reporting-on-Form-1042-S>; Internal Revenue Service, *Instructions for Form 1042-S (2013) - Foreign Person's U.S. Source Income Subject to Withholding*, *General Instructions* supra.

107 "Every withholding agent must file an information return on Form 1042-S (or such other form as the IRS may prescribe) to report to the IRS chapter 4 reportable amounts as described in paragraph (d)(2)(i) of this section that were paid to a recipient during the preceding calendar year. A separate Form 1042-S must be filed with the IRS for each recipient of an amount subject to reporting. A separate Form 1042-S must also be filed with the IRS for each separate type of payment made to a single recipient." See Prop. Reg. Sec. 1.1474-1(d)(1)(i).

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or each NFFE partner, owner or beneficiary if the NFFE is a flow-through entity.¹¹⁰ The withholding agent must ultimately include all such information in the annual income tax return that it files on IRS Form 1042.¹¹¹

"Non-Withholdable Payment" Status

Furthermore, an NFFE may demonstrate that a payment it received or made to a payee is effectively connected with a U.S. trade or business, and thus a "non-withholdable payment", if the withholding agent is able to reliably associate the payment with a valid Form W-8ECI.¹¹² IRS Form W-8ECI is generally filed by a foreign recipient of effectively connected income to establish that it is the beneficial owner of the income being reported but not a U.S. person, and also to claim that the reported income is effectively connected with the conduct of a U.S. trade or business and not subject to withholding.¹¹³ A valid Form W-8ECI will be deemed sufficient to establish such

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- 108 "Every withholding agent must file an information return on Form 1042-S...to report to the IRS chapter 4 reportable amounts...that were paid to a recipient during the preceding calendar year." See Prop. Reg. Sec. 1.1474-1(d)(1)(i). "The term recipient under this paragraph (d) means a person that is a recipient of a pass-thru payment (including a withholdable payment)...and includes:...(5) An NFFE except to the extent described in paragraph (d)(1)(ii)(A)(6) of this section; (6) A partner, owner, or beneficiary in a flow-through entity that is an NFFE when the withholding agent treats such partner, owner, or beneficiary as a payee and beneficial owner for purposes of determining the amount required to be withheld under §1.1472-1;" See Prop. Reg. Sec. 1.1474-1(d)(1)(ii)(A). "Persons that are not recipients include...(3) A flow-through entity that is an NFFE to the extent that the withholding agent treats a partner, owner, or beneficiary of the NFFE as a recipient pursuant to paragraph (d)(1)(ii)(A)(6) of this section; (4) An owner of an NFFE except as otherwise provided in paragraph (d)(1)(ii)(A)(6) of this section;" See Prop. Reg. Sec. 1.1474-1(d)(1)(ii)(B).
- 109 "If the beneficial owner of a payment made by a U.S. withholding agent is...an NFFE... it [the withholding agent] must complete Form 1042-S treating such entity as the recipient of the payment." See Prop. Reg. Sec. 1.1474-1(d)(4)(i)(A). "A U.S. withholding agent that makes payments of chapter 4 reportable amounts to an NFFE shall complete Forms 1042-S treating the NFFE as the recipient unless such withholding agent treats a partner, owner, or beneficiary in a flow-through entity that is an NFFE as a payee for purposes of determining the amount required to be withheld". See Prop. Reg. Sec. 1.1474-1(d)(4)(i)(D).
- 110 See Prop. Reg. Sec. 1.1474-1(d)(4)(i)(D). "If a U.S. withholding agent makes a payment of a chapter 4 reportable amount to a flow-through entity that is an NFFE,...it must complete a separate Form 1042-S for each recipient that is an owner of or account holder in such entity to the extent the withholding agent can reliably associate the payment with valid documentation... with respect to each such recipient. If a payment is made through tiers of such entities, the withholding agent must nevertheless complete Form 1042-S for each recipient to the extent it can reliably associate the payment with documentation provided with respect to that recipient." See Prop. Reg. Sec. 1.1474-1(d)(4)(ii)(A).
- 111 "Every withholding agent shall file an income tax return on Form 1042 (or such other form as the IRS may prescribe) to report chapter 4 reportable amounts...This income tax return shall be filed on the same income tax return used to report amounts subject to reporting for chapter 3 purposes." See Prop. Reg. Sec. 1.1474-1(c)(1). See also Internal Revenue Service, *Instructions for Form 1042 Annual Withholding Tax Return for U.S. Source Income of Foreign Persons (2012)*, accessible at: <http://www.irs.gov/pub/irs-pdf/i1042.pdf> ("Every withholding agent or intermediary required to file Form(s) 1042-S (whether or not any tax was withheld or was required to be withheld)...must file Form 1042.") *Id.*
- 112 See Prop. Reg. Sec. 1.1471-3(b)(4).
- 113 See Internal Revenue Service, *Instructions for Form W-8ECI (Rev. Feb. 2006) Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States*, accessible at: <http://www.irs.gov/pub/irs-pdf/iw8eci.pdf>. Form W-8ECI was recently updated to incorporate the requirements of FATCA. See Internal Revenue Service, *Draft Form W-8ECI - Certificate of Foreign Person's Claim That Income Is Effectively Connected With the Conduct of a Trade or Business in the United States*, accessible at: <http://www.irs.gov/pub/irs-dft/iw8eci--dft.pdf> ("Persons submitting this form must file an annual U.S. income tax return to report income claimed to be effectively connected with a U.S. trade or business") *Id.*

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payment status if, in addition to meeting all of the form's instructions, it contains the payee's TIN, represents that the reported amounts are effectively connected with a U.S. trade or business and includable in the payee's gross income, and is signed under penalties of perjury by a person authorized by the payee.¹¹⁴

Final regulations may be anticipated to address the types of documentation that an NFFE must present and upon which a withholding agent may rely for chapter 4 purposes to validate non-withholdable U.S. source "ordinary course of business" payments the NFFE receives from a PFFI or other third party payor(s).¹¹⁵

"Excepted NFFE" Status

Moreover, an NFFE must present to a withholding agent certain prescribed documentation to establish its chapter 4 status for purposes of qualifying under one or more of the "excepted NFFE" 30% withholding exemptions. In general, an NFFE may establish prima facie its status as a publicly traded corporation, a corporate affiliate of a publicly traded corporation, a territory entity, and an active NFFE by delivering to the withholding agent a valid owner withholding certificate¹¹⁶ or beneficial owner withholding certificate identifying itself or another NFFE payee as having such status.¹¹⁷ Where any such NFFE has received a payment with respect to an offshore obligation¹¹⁸ or pre-existing offshore obligation,¹¹⁹ the NFFE must provide to the withholding agent an organizational document, financial statement, or credit report and a written statement

114 See Prop. Reg. Sec. 1.1471-3(c)(v).

115 It does not appear that either the proposed regulations or IRS guidance to-date addresses this issue.

116 "A withholding agent may treat a payee as an active NFFE...if it has a valid withholding certificate identifying the payee as an active NFFE." See Prop. Reg. Sec. 1.1471-3(d)(11)(iv).

117 An NFFE may establish its status as a publicly-traded corporation by delivering a beneficial owner withholding certificate that identifies itself or another NFFE as payee, certifies its stock as regularly traded on one or more established securities markets, and provides the name of the exchange upon which its stock is traded. See Prop. Reg. Sec. 1.1471-3(d)(11)(i). An NFFE may establish its status as a corporate affiliate of a publicly traded corporation by delivering "a beneficial owner withholding certificate that identifies [itself or another NFFE] as a foreign corporation that is an affiliate of an entity whose stock is regularly traded on an established exchange and provides the name of the entity that is regularly traded and one of the exchanges upon which the entity's stock is listed." See Prop. Reg. Sec. 1.1471-3(d)(11)(ii). An NFFE may establish its status as a territory NFFE if it delivers "a beneficial owner withholding certificate that identifies [itself or another NFFE] as...[having been] organized in a [U.S.] possession...and includes a certification for chapter 4 purposes that all of the owners of [such NFFE or other NFFE] are bona fide residents of that possession." See Prop. Reg. Sec. 1.1471-3(d)(11)(iii).

118 The term "obligation" has been defined as "any legal agreement that produces or could produce a pass-thru payment [i.e., a payment attributable to a withholdable payment]...[It]...includes, for example...a bond, guaranteed investment certificate, or term deposit...a line of credit or a revolving credit facility...[provided the agreement was issued with binding, fixed material terms, including maturity date]...[a life insurance contract payable upon death or an earlier cash surrender date]...a term certain annuity contract...[and] a derivatives transaction...[based on]...an ISDA Master Agreement and evidenced by a confirmation." See Prop. Reg. Sec. 1.1471-2(b)(2)(ii).

119 The term "preexisting obligation" has been defined as "any account, instrument, or contract maintained or executed by the withholding agent as of January 1, 2013...[and]...any account, instrument, or contract maintained or executed by [an] FFI prior to the date that the participating FFI's FFI agreement becomes effective." See Prop. Reg. Sec. 1.1471-1(b)(48).

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signed under penalties of perjury or other documentary evidence confirming its particular NFFE status.¹²⁰ The proposed regulations offer transitional rules for payments made before January 1, 2017 with respect to pre-existing "obligations."¹²¹

An NFFE that fails to qualify as an "excepted NFFE" – i.e., a "passive NFFE" – may be called upon by a withholding agent to provide a valid withholding certificate that identifies itself as a passive NFFE.¹²² A passive NFFE that is not a WP or WT intermediary "will be required to provide either a written certification that it does not have any substantial U.S. owners or the name, address, and TIN of each substantial U.S. owner of the NFFE."¹²³ A passive territory NFFE that is not a WP or WT intermediary will be required to provide "the same certification or information...but only with respect to substantial U.S. owners of the NFFE that are not bona fide residents of the possession in which the NFFE was organized."¹²⁴

Conclusion:

While the FATCA regime primarily holds PFFIs and other withholding agents ultimately responsible for reporting information to the IRS about, and where appropriate, withholding a 30% tax from, U.S. source payments made directly and indirectly to NFFEs, NFFEs, which are usually in varying degrees of privity with their beneficial owners, bear the fundamental and often not-insubstantial burden of satisfying that obligation. In other words, FATCA provides no "Get-Out-Of-Jail-Free-Card"¹²⁵ for NFFEs.

For more information on FATCA, see [2012 Emerging Issues 6831](#); [2012 Emerging Issues 6455](#); [2012 Emerging Issues 6586](#); [2012 Emerging Issues 6174](#)

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120 For NFFE evidentiary requirements with respect to "offshore obligation" payments, See Prop. Reg. Sections 1.1471-3(d)(11)(i)(B)(1)-(3); 1.1471-3(d)(11)(ii)(B)(1)-(3); 1.1471-3(d)(11)(iii)(A)(1)-(3); 1.1471-3(d)(11)(iv)(B). For NFFE evidentiary requirements with respect to "preexisting offshore obligation" payments, See Prop. Reg. Sections 1.1471-3(d)(11)(i)(C); 1.1471-3(d)(11)(ii)(C)(1)-(4); 1.1471-3(d)(11)(iii)(B); 1.1471-3(d)(11)(iv)(C)(1)-(2).

121 See Prop. Reg. Sections 1.1471-3(d)(11)(i)(A)(1)-(3); 1.1471-3(d)(11)(ii)(A)(1)-(3); 1.1471-3(d)(11)(iv)(A).

122 See Prop. Reg. Sec. 1.1471-1(d)(11)(vi).

123 See Prop. Reg. Sec. 1.1471-1(d)(11)(vi)(D)(1). Certain transition and derogation rules apply to evidentiary rules applicable to passive NFFEs as well. See Prop. Reg. Sections 1.1471-1(d)(11)(vi)(A); 1.1471-1(d)(11)(vi)(B)-(C); 1.1471-1(d)(11)(vi)(D)(2).

124 *Id.*

125 See Wikipedia, *Get Out of Jail Free Card*, accessible at: http://en.wikipedia.org/wiki/Get_Out_of_Jail_Free_card.

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