
IRS Extends Timeline for Due Diligence and Other Requirements Under FATCA—Implications for Private Investment Funds

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Introduction

On October 24, 2012, the Internal Revenue Service (“IRS”) issued [Announcement 2012-42](#) (the “Announcement”), which further extends the timeline for completion of certain due diligence and other requirements and provides additional guidance concerning gross proceeds withholding and the status of certain instruments as grandfathered obligations under Sections 1471 through 1474 of the Internal Revenue Code (commonly referred to as the “Foreign Account Tax Compliance Act” or “FATCA”). The Department of the Treasury and IRS intend to incorporate the rules described in the Announcement in the final Treasury Regulations under FATCA (the “Final Regulations”) which are expected to be issued by the end of this year. The rules described in the Announcement modify certain aspects of the proposed Treasury Regulations (the “Proposed Regulations”) issued by the IRS in February, 2012.

Under FATCA, a private investment fund formed under the laws of a non-U.S. jurisdiction generally will be treated as a “foreign financial institution” (an “FFI”) and will be required to enter into an agreement with the IRS (an “FFI Agreement”) and to comply with certain due diligence, reporting and withholding obligations with respect to its account holders (i.e., the investors in the fund) or else suffer a 30% withholding tax on any “withholdable payments” that the FFI receives. An FFI that enters into an FFI Agreement and otherwise complies with FATCA is a “participating FFI.” A private investment fund formed under U.S. law may also have certain obligations under FATCA as a withholding agent, including withholding the 30% FATCA tax from any withholdable payments allocable to an FFI that has not entered into an FFI Agreement with the IRS (a “nonparticipating FFI”) and certain other account holders.

The Announcement is the fifth piece of guidance issued by the IRS with respect to FATCA. Please see our prior Client Alerts on this topic which discuss the initial pronouncement issued in [August, 2010](#) (IRS Notice 2010-60), the additional guidance issued in [April, 2011](#) (IRS Notice 2011-34) and [July, 2011](#) (IRS Notice 2011-53), and the Proposed Regulations issued in [February, 2012](#).

Guidance in Announcement Relevant to Private Investment Funds

The Announcement provides guidance regarding several aspects of FATCA. Certain aspects of the Announcement that are particularly relevant to private investment funds are summarized below.

1. *Extension of Timeline for Implementing New Account Opening Procedures*

FATCA requires withholding agents, including participating FFIs and “registered deemed-compliant FFIs” (i.e. specified types of FFIs identified under the Proposed Regulations that will not be required to enter into an FFI Agreement with the IRS), to implement new account opening procedures designed to identify U.S. accounts. The Announcement delays the required implementation of these procedures to **January 1, 2014** (or, if later, the effective date of a participating FFI’s FFI Agreement or the date on which an FFI registers as a deemed-compliant FFI).

2. *Modification of Timelines for Completing Due Diligence on Preexisting Accounts*

FATCA requires withholding agents (including participating FFIs and registered deemed-compliant FFIs) to complete certain due diligence requirements with respect to preexisting accounts, including documenting the status of entities owning preexisting accounts, and identifying U.S. accounts. The Announcement modifies the timelines for completing due diligence on certain preexisting accounts, as described below.

- *Due Diligence Timeline for Preexisting Accounts of Prima Facie FFIs.* Withholding agents, other than participating FFIs, will be required to complete due diligence with respect to preexisting accounts of “prima facie FFIs” (as defined in the Proposed Regulations at § 1.1471-2(a)(4)(ii)) by **June 30, 2014**. Participating FFIs will be required to complete due diligence with respect to preexisting accounts of prima facie FFIs within **six months of the effective date of their FFI Agreement** (which will generally be by June 30, 2014, as the Announcement states that the Final Regulations will provide that an FFI Agreement entered into before January 1, 2014 will be effective on January 1, 2014).
- *Due Diligence Timeline for Preexisting Accounts of Entities other than Prima Facie FFIs.* Withholding agents, other than participating FFIs, will be required to complete due diligence with respect to preexisting accounts of entities, other than those identified as prima facie FFIs, by **December 31, 2015**. For participating FFIs the deadline is extended to the date that is **two years after the effective date of their FFI Agreement**.
- *Due Diligence Timeline for Preexisting High-Value Individual Accounts.* Participating FFIs will be required to complete due diligence on preexisting high-value individual accounts (defined in the Proposed Regulations as accounts exceeding \$1,000,000) by the later of **December 31, 2014**, or the date that is **one year after the effective date of their FFI Agreement**.
- *Due Diligence Timeline for Preexisting Individual Accounts other than High-Value Accounts.* Participating FFIs will be required to complete due diligence with respect to other preexisting individual accounts by the later of **December 31, 2015**, or the date that is **two**

years after the effective date of their FFI Agreement.

3. Reporting

The first deadline for a participating FFI to report the information required under FATCA to the IRS with respect to its United States accounts has been extended from September 30, 2014 to **March 31, 2015**. The first report will still cover information relating to the 2013 and 2014 calendar years.

4. Deferral of Withholding on Gross Proceeds

The Announcement defers the date on which a withholding agent must begin withholding the 30% FATCA tax from any gross proceeds from the sale or other disposition of any property that can produce interest or dividends from U.S. sources ("U.S. Gross Proceeds"). U.S. Gross Proceeds withholding will now begin on January 1, 2017, rather than January 1, 2015. Withholding on payments of interest, dividends or other "fixed or determinable annual or periodical" income from sources within the United States ("U.S. FDAP"), which begins on January 1, 2014 under the Proposed Regulations, has not been deferred.

5. Expansion of Scope of Grandfathered Obligations

Under FATCA and the Proposed Regulations, any payment made under "an obligation" (as defined in the Proposed Regulations) outstanding on January 1, 2013 (a "grandfathered obligation") or any U.S. Gross Proceeds from the disposition of such obligation will not be subject to FATCA withholding. The Announcement expands the scope of grandfathered obligations to include:

- obligations that produce or could produce a foreign passthru payment and that cannot produce a withholdable payment, provided that the obligation is outstanding as of the date that is six months after the date on which final regulations defining the term "foreign passthru payment" are filed with the Federal Register;
- any instrument that gives rise to a withholdable payment solely because the instrument is treated as giving rise to a dividend equivalent payment pursuant to Section 871(m) of the Internal Revenue Code, so long as the instrument is outstanding on the date that is six months after the date on which instruments of its type first become subject to such treatment; and
- any obligation to make payments with respect to, or to repay, collateral posted to secure obligations under a notional principal contract that is itself a grandfathered obligation.

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Authors



**Richard E.
Andersen**

RETIRED PARTNER

☎ +1 212 230 8800

William C. Benjamin

RETIRED PARTNER