WHAT MUST FOREIGN TRUSTS AND FAMILY CORPORATIONS DO ABOUT F.A.T.C.A.?

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After years of preparation and trepidation, the Foreign Account Tax Compliance Act ("F.A.T.C.A.") will soon become effective. While F.A.T.C.A. was initially targeted to major commercial and investment banks aiding U.S. persons in avoiding paying tax on their income, F.A.T.C.A.'s effective scope is far broader, covering any foreign trust or family corporation. Starting on July 1, 2014, F.A.T.C.A. can impose a new 30% U.S. withholding tax on payments of interest, dividends and other amounts from the U.S. to *any* foreign person unless that person complies with F.A.T.C.A. regulations. If the foreign person is a foreign financial institution ("F.F.I."), compliance is onerous. However, with the recent revisions to the regulations and careful planning, the foreign trust or family corporation may be considered a non-financial foreign entity ("N.F.F.E.") and thus subject to far less burdensome requirements.

F.A.T.C.A. divides the world of non-U.S. investors into two categories: F.F.I.'s and N.F.F.E.'s. The crucial factor for any foreign person is to first determine its classification. As F.F.I. status results in a much greater burden for an entity and the deadlines for actions are fast approaching, obtaining N.F.F.E. status holds numerous advantages. For a typical foreign trust or family corporation that holds investments for its beneficiaries or shareholders, this determination had been clouded in uncertainty, until the I.R.S.'s recent issuance of temporary F.A.T.C.A. regulations.

Under F.A.T.C.A. regulations, a foreign trust or family corporation that derives its income from investments will be categorized as an F.F.I. if (1) the trust or corporation is managed by a business entity and not an individual and (2) that manager has investment discretion concerning what the trust or corporation buys or sells. For example, if the trust retains a large commercial bank or investment bank as its investment manager and that investment manager has discretion on securities to buy or sell, the trust is treated as an F.F.I. By contrast, if the trust retains an investment manager who is a sophisticated individual working on his or her own, or a family member, the trust would not be an F.F.I. In that case, the trust would be a passive N.F.F.E. that is subject to far less burdensome requirements under F.A.T.C.A.

If the trust or family corporation is treated as an F.F.I., it will be required to register on the F.A.T.C.A. electronic portal to become a participating F.F.I. ("P.F.F.I."). A P.F.F.I. is not subject to F.A.T.C.A. withholding. Among the many burdens imposed on the P.F.F.I. is the requirement to search its records or obtain documentation to see if it has a U.S. grantor, a U.S. beneficiary, a U.S. shareholder, or a U.S. controlled foreign entity. The P.F.F.I. must disclose the U.S. person's identity and certain related information to the I.R.S. Registration to become a P.F.F.I. is subject to a tight deadline. The I.R.S. has stated that, unless an F.F.I. registers by April 25, it cannot be assured that the F.F.I. will receive a Global Intermediary Identification Number ("G.I.I.N.") in time to prevent F.A.T.C.A. withholding.

"A passive N.F.F.E. can register with the I.R.S. to become a Direct Reporting N.F.F.E. This will allow greater confidentiality for the investors in the N.F.F.E. because the names of those U.S. persons will not be furnished to the withholding agent."

However, help may be available to lessen some of the burdens on the trust or corporation and to provide more time to act. The U.S. has signed 24 Inter-Governmental Agreements relating to F.A.T.C.A. ("I.G.A.'s") and the list is growing. For those countries that have signed a Model 1 I.G.A. (such as the U.K., Canada, the Cayman Islands, and Bermuda), the April 25 deadline is extended by six months. Additionally, the entity is obligated to report the names of the U.S. investors to the local country, rather than the I.R.S. However, Model 1 I.G.A. status does not completely eliminate the need to take action. Rather, I.G.A. status gives the F.F.I. more time by delaying registration or F.A.T.C.A. withholding until January 1, 2015.

If the trust or family corporation is treated as a passive N.F.F.E. rather than an F.F.I., it need not obtain a G.I.I.N. and is not subject to the same level of due diligence that is imposed upon an F.F.I. The foremost compliance burden placed on a N.F.F.E. is the requirement to disclose the names of certain U.S. shareholders and beneficiaries. U.S. shareholders owning more than 10% of the company, beneficiaries having a greater than 10% interest in the trust, and possibly the name of a U.S. grantor will need to be disclosed on I.R.S. Form W-8BEN-E. Form W-8BEN-E will be given by the trust or corporation to the U.S. withholding agent paying the interest, dividends, sales proceeds, redemption proceeds, and other items of U.S. source passive income. The U.S. withholding agent will alert the I.R.S. of the identity of these U.S. persons on Form 8966.

A passive N.F.F.E. that must disclose the identity of a U.S. person is given a new option in the recently finalized regulations. A passive N.F.F.E. can register with the I.R.S. to become a Direct Reporting N.F.F.E. This will allow greater confidentiality for the investors in the N.F.F.E. because the names of those U.S. persons will not be furnished to the withholding agent. The N.F.F.E. will provide the withholding agent with a G.I.I.N. that indicates the direct reporting N.F.F.E. status and provide the names of the U.S. investors directly to the I.R.S. on Form 8966. This option can simplify the reporting burdens all involved parties and also preserve the secrecy of the U.S. persons, except with regard to the I.R.S.

Foreign trusts and family corporations need to begin to consider how to deal with F.A.T.C.A. The initial impact of F.A.T.C.A. may not be felt, due to special rules that treat certain pre-July 1, 2014 instruments as not subject to F.A.T.C.A. withholding, but eventually F.A.C.T.A. will catch up to everyone.