

# TAX 101: UPDATES TO PROCEDURES RELATING TO WITHHOLDING FOREIGN PARTNERSHIP OR TRUST AGREEMENTS AS A RESULT OF F.A.T.C.A.

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## Tags

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Chapter 3 of the Internal Revenue Code requires withholding on payments of certain types. These include “fixed or determinable annual or periodic income” (“F.D.A.P.”) to foreign persons, disposition of U.S. real property interests by foreign persons, and U.S. effectively connected income attributable to foreign partners of a partnership engaged in a U.S. trade or business. Historically, withholding agreements allowed a foreign partnership or trust to become a Withholding Foreign Partnership (“W.P.”) or a Withholding Foreign Trust (“W.T.”) and to assume the withholding and reporting responsibilities of a withholding agent under Chapter 3.

Chapter 4 of the Internal Revenue Code (regarding F.A.T.C.A.) generally requires foreign financial institutions (“F.F.I.’s”) to provide information to the Internal Revenue Service (“I.R.S.”) with regard to account holders who are U.S. persons. Chapter 4 also requires certain non-financial foreign entities (“N.F.F.E.’s”) to provide information on their substantial U.S. owners to withholding agents. Chapter 4 imposes a withholding tax on certain payments to F.F.I.’s and N.F.F.E.’s that fail to comply with their F.A.T.C.A. obligations. (For a more detailed discussion of F.A.T.C.A., please see our *Insights* monthly F.A.T.C.A. 24/7 column.)

On August 8, 2014, the I.R.S. released Rev. Proc. 2014-47,<sup>48</sup> which provides guidance on entering into W.P. and W.T. agreements and for renewing such agreements under F.A.T.C.A., thereby essentially integrating the two reporting systems. Rev. Proc. 2014-17 permits a W.P. and W.T. to assume the withholding and reporting responsibilities of a withholding agent under both Chapter 3 and Chapter 4. Rev. Proc. 2014-47 publishes revised W.P. and W.T. agreement procedures, which apply to W.P. and W.T. agreements effective on or after June 30, 2014. Additionally, existing W.P. and W.T. agreements are updated to coordinate with the withholding and reporting requirements of F.A.T.C.A.

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Rev. Proc. 2014-47 can be found here:  
<http://www.irs.gov/pub/irs-drop/rp-14-47.pdf>.

## IN GENERAL

The revised W.P. or W.T. agreements require a W.P. and W.T. to assume F.A.T.C.A. withholding responsibilities in addition to Chapter 3 withholding responsibilities. With respect to a withholdable payment of U.S.-source F.D.A.P. income that is subject to Chapter 3 withholding and that is not subject to withholding under Chapter 4 (F.A.T.C.A.), a withholding agent is required to report the applicable F.A.T.C.A. exemption code in addition to other information required to be reported. Amounts withheld under F.A.T.C.A. can be credited against liability or tax under Chapter 3.

Applications for new agreements must establish to the satisfaction of the I.R.S. that the applicant has adequate resources and has established appropriate practices and procedures to comply with the terms of the W.P. or W.T. agreement. An application must include the information required by Form 14345 (Qualified Intermediary Application), a completed Form SS-4 (Application for Employer Identification Number), and any additional information and documentation requested by the I.R.S. Once the W.P. or W.T. application is approved, the I.R.S. will send an approval notice including a W.P.-E.I.N. or W.T.-E.I.N. assigned to the entity. This identification number will be employed when fulfilling the requirements of a W.P. or W.T. under Chapters 3 and 4, such as making tax deposits and filing Forms 1042, 1042-S, and 8966.

A W.P. or W.T. that has: (i) executed a W.P. or W.T. agreement, (ii) seeks to renew its W.P. or W.T. agreement, and (iii) intends to register (or has registered) as a participating F.F.I., registered deemed-compliant F.F.I., or sponsoring entity, must do so by submitting a registration form through the F.A.T.C.A. registration website and including the information requested for renewal. Upon completion of the registration process and approval by the I.R.S., a W.P. or W.T. will be issued a G.I.I.N. to be used to identify its F.A.T.C.A. (Chapter 4) status to withholding agents and to tax administrators, if applicable, for F.A.T.C.A. reporting. A W.P. or W.T. will retain its previously issued W.P.-E.I.N. or W.T.-E.I.N. for fulfilling the requirements of a W.P. or W.T.

An existing W.P. or W.T. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity<sup>49</sup> may not use the F.A.T.C.A. registration website and must renew its W.P. or W.T. agreement by submitting a request for renewal to the Foreign Intermediaries Program. Such entities will not need to obtain a G.I.I.N.

A W.P. or W.T. will be required to report partners, beneficiaries, or owners that are U.S. non-exempt recipients on Form 8966 (F.A.T.C.A. Report), Schedule K-1 (Form 1065), or Form 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner) to the extent required under the W.P.'s or W.T.'s F.A.T.C.A. requirements or the W.P. or W.T. agreement.

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As defined in §1.1471-1(b)(124).

## THE REVISED AGREEMENTS

The new procedures require that a W.P. or W.T. that is an F.F.I. (other than a retirement fund) will agree to satisfy the requirements and obligations of its specific F.F.I. status. The applicable F.F.I. statuses include: (i) a participating F.F.I. (including a reporting Model 2 F.F.I.), (ii) a registered deemed-compliant F.F.I. (including a reporting Model 1 F.F.I. and a non-reporting Model 2 F.F.I. treated as registered deemed-compliant), or (iii) a registered deemed-compliant Model 1 I.G.A. F.F.I. An F.F.I. that is treated as a certified deemed-compliant F.F.I. may enter into a W.P. or W.T. agreement if it agrees to assume the responsibilities of one of the abovementioned statuses.

An F.F.I. that enters into a W.P. or W.T. agreement will be subject to F.A.T.C.A. obligations with respect to all of its partners, beneficiaries, or owners that are account holders for F.A.T.C.A. purposes, irrespective of whether the F.F.I. is acting as a W.P. or W.T. with respect to the partner, beneficiary, or owner. When an F.F.I. chooses to act as a W.P. or W.T. with respect to a partner, beneficiary, or owner that is an account holder for F.A.T.C.A. purposes, the W.P. or W.T. must comply with its F.A.T.C.A. obligations, except when such obligations have been explicitly modified in the W.P. or W.T. agreement (e.g., the timing for when a W.P. or W.T. is required to withhold on a withholdable payment).

Like the existing W.P. and W.T. agreements, the revised W.P. and W.T. agreements prohibit reliance on the presumption rules<sup>50</sup> with respect to direct partners, beneficiaries, or owners and retain an automatic termination provision for a W.P. or W.T.'s failure to obtain documentation for such direct partner, beneficiary, or owner. The revised agreements provide for the use of documentary evidence, in lieu of a Form W-8 or Form W-9, for direct partners, beneficiaries, or owners, provided that the W.P. or W.T. is an F.F.I. that is subject to the "know-your-customer" practices and procedures of a jurisdiction that the I.R.S. has approved.<sup>51</sup> The rules permitting the use of documentary evidence do not apply to an N.F.F.E. acting as a W.P. or W.T. Such W.P.'s or W.T.'s are required to obtain Forms W-8 and W-9 to document their partners, beneficiaries, or owners.

The revised W.P. and W.T. agreements replace the external audit requirement of the existing agreements with an internal compliance program. As part of the internal compliance program, a W.P. or W.T. is required to designate a responsible officer who will oversee the program and who will make a periodic certification of the W.P. or W.T. agreement and provide certain factual information regarding the results of the W.P. or W.T.'s internal compliance review. The factual information requested will vary depending on the reportable amounts received by the W.P. or W.T. and whether the W.P. or W.T. makes a pooled reporting election. A periodic certification will be required once every three calendar years that the agreement is

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<sup>50</sup> The presumption rules generally apply to determine the status of a payee when the withholding agent cannot reliably associate the payment with valid documentation.

<sup>51</sup> A list of approved jurisdictions can be found at: <http://www.irs.gov/Businesses/International-Businesses/List-of-Approved-KYC-Rules>.

*“The revised W.P. and W.T. agreements replace the external audit requirement of the existing agreements with an internal compliance program.”*

in effect (including extensions). The W.P. or W.T. will be required to arrange for a periodic review of its compliance with the W.P. or W.T. agreement during the three-year certification period. However, the review report will not be required to be filed with the I.R.S. unless specifically requested.

The existing W.P. or W.T. agreements do not allow a W.P. or W.T. to act as a W.P. or W.T. for its indirect partners, beneficiaries, or owners, except in two specific situations, both of which require a written agreement between the W.P. or W.T. and another foreign partnership or foreign trust. The revised agreements require that a partnership or trust to which a W.P. or W.T. may apply the joint account or agency option must maintain a permissible Chapter 4 status. The agreements to apply the joint account or agency option are subject to special transitional rules.

The revised agreements permit a W.P. that meets certain conditions to either not file a partnership return or a Schedule K-1 for certain foreign partners, depending on whether the W.P. has any direct or indirect partners.

Modification of the agreement is possible by a rider only if the W.P. or W.T. has unique facts and circumstances that necessitate a modification. The I.R.S. may agree or refuse to modify the W.P. or W.T. agreements at its sole discretion. With respect to modifying the agreement to reduce the rate of withholding under Chapter 3, such modification does not require a rider and may be made if the W.P. or W.T. obtained a valid Form W-8BEN from a direct partner, beneficiary, or owner on which a claim of treaty benefits was made, including the appropriate limitation on benefits and Code §894 certifications, if applicable.

## **RENEWAL OF AGREEMENTS: EFFECTIVE DATES**

A W.P. or W.T. that applied to renew its W.P. or W.T. status on the F.A.T.C.A. registration website and that was approved by the I.R.S. on or before August 31, 2014 will have an agreement with effective date of June 30, 2014. A W.P. or W.T. that applies to renew its status on the F.A.T.C.A. registration website and is approved by the I.R.S. after August 31, 2014 will have the effective date of the date the renewal was approved. The date the renewal is approved is the later of the date the W.P. or W.T. is issued a G.I.I.N. or the date the W.P. or W.T. submits a request for renewal.

A W.P. that is an F.F.I. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity that applied to renew its W.P. or W.T. agreement and the application was approved by the I.R.S. on or before August 31, 2014, will have an agreement with an effective date of June 30, 2014. A W.P. or W.T. that is a retirement fund or an N.F.F.E. that is not a sponsoring entity and that applied to renew its status after August 31, 2014 and that is approved by the I.R.S. will have an agreement with an effective date of the date of renewal as provided in the I.R.S.'s approval notice.

## **NEW AGREEMENTS: EFFECTIVE DATES**

An entity that is an F.F.I. (other than a retirement fund) that applied for W.P. or W.T. status before August 31, 2014 and was approved will have an agreement with an effective date of June 30, 2014, provided that it obtains a G.I.I.N., if it has not already done so, within 90 days of such approval. An F.F.I. that applied after

August 31, 2014 will have an effective date of the date the entity is issued a W.P.-E.I.N. or W.T.-E.I.N., if its application is approved and provided that it obtains a G.I.I.N., if it has not already done so, within 90 days of such approval.

An entity that is a retirement fund or an N.F.F.E. that is not a sponsoring entity will have an agreement with an effective date of the date the entity is issued a W.P.-E.I.N. or W.T.-E.I.N., if its application is approved.

An entity that submitted an application for W.P. or W.T. status and that is approved by the I.R.S. during the 2014 calendar year may act as a W.P. or W.T. in accordance with the revised W.P. or W.T. agreements for the entire calendar year. With respect to amounts subject to Chapter 3 withholding received before June 30, 2014, the entity may act in accordance with the existing procedures as if the W.P. or W.T. agreement was effective on January 1, 2014 and expired on June 30, 2014. Amounts subject to Chapter 3 withholding received between June 30, 2014 and September 1, 2014 will be treated as in the transitional procedures mentioned below.

Applications for W.P. or W.T. status submitted in any calendar year after 2014, if approved, will be effective as of January 1 of the calendar year, if they are received on or before March 31 of that calendar year. Applications for W.P. or W.T. status received on or after April 1, if approved, will be effective as of January 1 of the following calendar year.

## TRANSITIONAL PROCEDURES

An entity that received a withholdable payment under F.A.T.C.A., or an amount subject to Chapter 3 withholding, prior to September 1, 2014 may represent itself to its withholding agent as a W.P. or W.T., provided that the entity complies with the W.P. or W.T. agreement in effect prior to June 30, 2014 and, in the case of an existing W.P. or W.T., the entity has submitted a request for renewal on or before August 31, 2014. A W.P. or W.T. that makes a distribution for which withholding is required under F.A.T.C.A. beginning July 1, 2014 and does not withhold to the extent required under the revised agreements must make up the difference during the same calendar year.<sup>52</sup>



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The procedures that must be followed are similar to those that apply to under-withholding under Chapter 3. See Treas. Reg. §1.1474-2(b) and §1.1461-2(b).