



April 12, 2012  
(Updated April 25, 2012)

## Summary and Request for Comment

# U.S. IRS Proposed “Foreign Account Tax Compliance Act” Regulation

### Executive Summary

On February 8, 2012 the Internal Revenue Service (IRS), the United States tax authority that is a U.S. Treasury Department bureau, proposed a regulation that will affect non-U.S. credit unions as well as U.S. credit unions.

The IRS proposed rule would implement the Foreign Account Tax Compliance Act (FATCA), [Internal Revenue Code \(I.R.C.\) §§ 1471-1474](#), which the U.S. Congress enacted in March 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act. Congress enacted FATCA in order to make it harder for U.S. taxpayers [to avoid U.S. income taxation by placing funds in overseas accounts](#). FATCA is therefore presumed to increase U.S. tax revenue without raising tax rates. The proposed FATCA rules would regulate U.S. credit unions as well as “foreign financial institutions” (FFIs)—including non-U.S. credit unions—and would subject international electronic funds transfers that involve not-yet-taxed income attributable to U.S. income sources (such as income earned by a U.S. citizen or U.S. resident or from an investment located in the U.S.) to a 30% “withholding” for tax compliance purposes. Additional information about the proposal can be accessed at this [link](#).

The IRS will be accepting public comments regarding the proposed rule, which can be accessed [here in 12 point font](#), or here in the [8 point font Federal Register version](#),<sup>1</sup> until April 30, 2012. **Please provide comments to the World Council by Thursday, April 26<sup>th</sup> (if not sooner) so that we can use your input to help form our comment letter on this very important issue.** Please provide comments and ask any questions you may have regarding the proposal to World Council’s Chief Counsel and VP for Advocacy & Government Affairs Michael Edwards at [medwards@woccu.org](mailto:medwards@woccu.org).

The proposed regulation, if finalized as proposed, would require non-U.S. credit unions to register with the IRS or be possibly blacklisted by major financial institution and the U.S. government as a “nonparticipating FFI” because the FATCA proposed regulations would not permit financial institutions that agree to be FATCA compliant to hold accounts by

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<sup>1</sup> The *Federal Register* is the official legal journal of the United States federal government. The full legal citation for the IRS’s proposed FATCA rules is as follows:

Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities, 77 Fed. Reg. 9022 (proposed Feb. 15, 2012), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-02-15/pdf/2012-2979.pdf>.



“nonparticipating FFIs.” Internationally active non-U.S. credit unions and U.S. credit unions would also face additional requirements, as detailed below.

- **In General, FATCA Applies to “Withholdable Payments” Involving Untaxed Investment or Interest Income Earned by “Specified U.S. Persons” Who Do Not Live in a Non-U.S. Credit Union’s Home Country:** FATCA only requires tax withholding from “withholdable payments” (as defined below in sections 2 and 5 of the Summary) involving income that has not yet been subject to U.S. income tax “withholding” (in general, this means income from dividends or interest, or from the sale of U.S. investments or investment property) which was earned by “specified U.S. persons” who are not residents of an FFI’s home country. The FATCA withholding rules, as proposed, are not geared towards wage income.
  - **U.S. Citizens and U.S. Residents:** In the context of credit unions, a “specified U.S. person” is usually “a citizen or [resident](#) of the United States,” as further defined below in section 2 of the Summary (“Definitions”) unless that person is a resident of the credit union’s home country if the credit union is a “Local FFI,” as defined in section 3 of this Summary, below. (U.S. credit unions would be required to comply with the FATCA withholding and other rules in the case of any “specified U.S. person” regardless of the individual’s place of residence.) Under U.S. law, a person can have more than one legal “residence,” meaning that a “U.S. resident” can also be considered a “resident” of another country simultaneously depending on factors such as the amount of time spent in each country.
- **Most Non-U.S. Credit Unions Can Qualify as Partially Exempt “Local FFIs:”** Most non-U.S. credit unions would be partially-exempt from the FATCA regulations as “Local FFIs” and would need to only comply with streamlined FATCA requirements that involve primarily registering with the IRS using an online registration form. The “Local FFI” exemption is discussed in greater detail in section 3 of this Summary (“Non-U.S. Credit Unions as Partially-Exempt “Local FFIs”), below. A non-U.S. credit union would meet the “Local FFI” definition if it:
  - a) Does not have physical offices outside of its home country;
  - b) Has at least 98% of its accounts held by residents of the home country (which in the European Union (EU) includes residents of any EU country) – these local residents can also be U.S. citizens or U.S. residents so long as they have not ceased to be legal residents of the home country;
  - c) Meets other requirements listed in section 3 of this Summary, such as a set of streamlined “due diligence” requirements to determine whether it has large accounts (generally accounts larger than US\$ 50,000) that are held by “specified U.S. persons”



who are not residents of the credit union's home country and being located in a country that meets international anti-money laundering (AML) minimum standards; and

d) Registers with the IRS using the online form discussed in section 3, below.

- **Non-U.S. Credit Unions That Do Not Meet the “Local FFI” Definition Would Not Be Exempt and Would Need to Act as “Withholding Agents:”** Non-U.S. credit unions that do not meet the “Local FFI” exemption or a similar exemption would be required to act as “withholding agents” (as defined in section 2 and further discussed in section 5).
- **“Nonregistering Local Banks” Exemption:** The IRS has proposed to allow small non-U.S. banks to comply with FATCA even if they do not register with the IRS. Unfortunately, as proposed, non-U.S. credit unions would not likely meet the definition of “nonregistering local banks” because they are not “banks.” If, however, the IRS expands the definition of “nonregistering local banks” in its final version of this regulation to include non-U.S. credit unions, credit unions under US\$ 175 million in assets would likely be able to comply with FATCA without being required to register with the IRS pursuant to the “nonregistering local bank” rules. The World Council will be strongly urging the IRS to expand the definition of “nonregistering local bank” to include similar credit unions.
- **U.S. Credit Unions Would Need to Act as FATCA “Withholding Agents” If they Provide International Electronic Payments Services:** U.S. credit unions would be included in the proposed rule's definition of “withholding agent,” would be required to withhold taxes on certain transactions members make with FFIs, and would need to identify members' accounts held by FFIs and determine those accounts' status for tax compliance purposes using primarily AML information collected pursuant to the Bank Secrecy Act's “know your customer” rules. See sections 5 and 6 of this Summary for more information about the proposed compliance requirements for “withholding agents” and U.S. credit unions.

In addition, the IRS public hearing about the proposed rule is scheduled for May 15 in the auditorium located at the Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. The IRS must receive requests to speak and outlines of topics to be discussed at the public hearing by May 1, 2012.



## Detailed Summary of the IRS FATCA Proposed Regulation

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### 1) FATCA Implementation Dates

- **When Would the FATCA “Withholding” Begin?** In general, the FATCA rules would apply to payments may after December 31, 2013 that are “withholdable payments”—generally meaning investment income related to U.S. investments such as dividends, interest income, and/or proceeds from the sale of investments—as discussed in section 6 of this Summary, below. However, withholding on “foreign passthru payments” (this term is not yet defined but is discussed in section 6 of this Summary, below) by FFIs would not begin until 2017 and some payments would be exempt under the “transitional exemption” that applies to some payments made prior to January 1, 2015:

- 1) **Withholding on Payments to Certain FFIs Begins After December 31, 2013:** The proposed FATCA rules provide that the 30% withholding required by FATCA would apply to “withholdable payments” (as discussed in section 6 of this Summary) made after December 31, 2013, but withholding would not be required when a “participating FFI” or other “withholding agent” (such as a U.S. credit union) can reasonably associate the payment with documentation from the recipient of the payment (the “payee”) that the payment is exempt under the exemptions and special rules discussed immediately below under (2), (3), and (4).

- a) **As Stated by the IRS:** “Beginning on January 1, 2014, FFIs, like U.S. withholding agents, will be required to withhold on passthru



payments<sup>2</sup> that are withholdable payments. FFIs will also be required to report annually on the aggregate amount of certain payments to each nonparticipating FFI for the 2015 and 2016 calendar years.”

- 2) **General Exemptions:** Under these exemptions, withholding would not be required when:
- A. A withholding agent can associate the payment with a “grandfathered obligation” (generally defined as accounts or other obligations outstanding as of January 1, 2013, *see* proposed Treas. Reg. § 1.1471-2(b)) or
  - B. The withholding agent receives documentation from the payee that:
    - 1) The payment is to an “exempt” beneficial owner (such as a governmental entity or a tax-exempt organization);
    - 2) The payment is to “deemed-compliant FFI” such as a “Local FFI” that has registered with the IRS;
    - 3) The payment is to a financial institution organized in a U.S. territory (such as Puerto Rico); or
    - 4) The payment involves income from U.S.-based investments or interest-bearing deposits (such as interest, dividends, royalties), the payment is to an FFI that is a “participating FFI” for FATCA purposes (i.e. it is registered with the IRS and is not a “deemed-compliant FFI”) but does withhold taxes for the IRS, and the withholding agent receives: (a) a valid intermediary or “flow-through” “withholding certificate;” and (b) a valid FFI “withholding statement.”
- 3) **“Foreign Passthru Payment” Withholding Begins in 2017:** Many types of payments that would be subject to withholding under FATCA are “foreign passthru payments”—which are a subset of “withholdable payments” as defined in the proposal—but, as discussed below in section 6, the proposed rule does not contain a definition of “foreign passthru payments.” The proposal therefore would not require “withholding agents” to withhold taxes that involve “foreign passthru payments” until January 1, 2017.

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<sup>2</sup> A “passthru payment” is a catch-all term including any “withholdable payment” and any “foreign passthru payment.”



- a) **As Stated by the IRS:** “Beginning no earlier than January 1, 2017, the scope of passthru payments will be expanded beyond withholdable payments and FFIs will be required to withhold on such payments pursuant to and in accordance with future guidance. In the case of jurisdictions that enter into agreements to facilitate FATCA implementation, Treasury and IRS will work with the governments of such jurisdictions to develop practical alternative approaches to achieving the policy objectives of passthru payment withholding.”
- 4) **Transitional Exemption until January 2015:** In addition to the other exemptions discussed above, non-FATCA exempt credit union or other “withholding agents” (as defined below in section 2 of this Summary) would not be required to withholding funds from an otherwise “withholdable payment” (as defined below in section 2 of this Summary) that is made prior to January 1, 2015 if it involves a pre-existing account at an undocumented FFI (i.e. one that is not registered with the IRS) unless the undocumented FFI meets the definition of a “prima facie” FFI.
- **“Prima facie” FFIs** are most financial institutions, including credit unions, which have for payments system purposes either a “Standard Industry Codes” (SIC) number or a “North American Industry Classification System” (NAICS) code number. (The NAICS number for credit unions is “NAICS 522130.”) See section 2 of this Summary, below, for more details about the proposed definition of “prima facie” FFI.
- **When Would Reporting of the Identities of U.S. Account Holders Begin?** For “participating FFIs” (as defined below), the reporting the identities of the holders of U.S. accounts to the IRS would begin in 2014 (for the 2013 calendar year).
  - **When Would Reporting Income Information on U.S. Accounts Begin?** As proposed, the FATCA rules would require “participating FFIs” to begin reporting information about income involving U.S. taxpayers’ accounts starting in 2016 (for the 2015 calendar year).
  - **When Would Full Reporting on U.S. Account Begin?** As proposed, the FATCA rules would require “participating FFIs” to begin reporting full information about U.S. taxpayers’ accounts starting in 2017 (for the 2016 calendar year).



## 2) Definitions

- **“Participating FFI” Definition:** Participating FFIs are non-U.S. financial institution that do not meet the “Local FFI” definition or other types of partially-exempt “deemed compliant” FFIs, and have entered into the “FFI Agreement” required by proposed Treasury Regulations § 1.1471-4.<sup>3</sup>
- **“Nonparticipating FFI” Definition:** “Nonparticipating FFI means an FFI other than a participating FFI, a deemed-compliant FFI, or an exempt beneficial owner.”<sup>4</sup>
  - **Credit Unions that Fail to Register with the IRS will be “Nonparticipating FFIs:”** A non-U.S. credit union will be a “nonparticipating FFI” unless it registers with the IRS as a “Local FFI” (if it meets the requirements for the “Local FFI” partial exemption) or enters into an “FFI Agreement” with the IRS or—if the credit union is located in a country which has entered into a FATCA tax treaty with the U.S.—under the local country’s FATCA-related compliance regime that uses AML reporting (see section 8 of this Summary for more information about the tax treaty option).
    - i) **Payments to “Nonparticipating FFIs” Subject to FATCA Withholding:** U.S. financial institutions, FFIs that are not exempt from FATCA (and therefore enter into “FFI Agreements” with the IRS), and other FATCA “withholding agents” must “deduct and withhold tax with respect to passthru payments made to recalcitrant account holders and nonparticipating FFIs.”<sup>5</sup>
    - ii) **“Nonparticipating FFIs” May Not Be Entitled to Refunds of Withheld Taxes Even When No Tax is Due:** A “nonparticipating FFI (determined as of the time of payment) that is the beneficial owner of an item of income or other payment that is subject to withholding under [FATCA] shall not be entitled to any credit or refund pursuant to [I.R.C.] section 1474(b)(2) and [the FATCA refund rules] unless it is entitled to a reduced rate of tax with respect to the income or other payment by reason of any treaty obligation of the United States. If the nonparticipating FFI is entitled to a reduced rate of tax with respect to an item of income or other payment by reason of any treaty obligation of the United States, the amount of any credit or refund with respect to such tax shall not exceed the amount of credit or refund attributable to such reduction in rate on the item of

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<sup>3</sup> See proposed Treas. Reg. § 1.1471-1(b)(23)(v).

<sup>4</sup> Proposed Treas. Reg. § 1.1471-1(b)(23)(iv).

<sup>5</sup> Proposed Treas. Reg. § 1.1471-4(a)(1) (“Withholding.”).



income or other payment, and no interest otherwise allowable under [\[I.R.C.\] section 6611](#) shall be allowed or paid with respect to such credit or refund.”<sup>6</sup>

iii) **“Nonparticipating FFIs” May be Blacklisted by Internationally Active Commercial Banks and other Financial Institutions:** Although FATCA does not require FFIs that have entered into “FFI Agreements” to close the accounts of “nonparticipating FFIs” or “recalcitrant accountholders” in most situations, many FFIs may choose to stop doing business with “nonparticipating FFIs” in order to reduce their compliance burdens. In addition, “limited purpose branch” offices of “expanded affiliated group” FFIs would not be allowed to have accounts held in the name of “nonparticipating FFIs,” as explained below.

(1) **“Limited Purpose Branch” Rule:** The FATCA regulations for FFI “limited purpose branches” (for FFIs that are part of an “expanded affiliated group”) require such branch offices to agree to close the accounts of “nonparticipating FFIs” and “recalcitrant account holders” and also agree not to do business in the future with people and organizations meeting these definitions.<sup>7</sup> See section 9 of this Summary, below, for more information on the FATCA “expanded affiliated group” rules.

- **“U.S. Account” Definition:** In general, a “U.S. account” is defined as “any financial account maintained by a financial institution that is held by one or more specified U.S. persons or U.S. owned foreign entities.” However, accounts below US\$50,000 are typically exempt from the “U.S. account” definition, and special rules for certain types of accounts.
  - **Exception from the “U.S. Account” Definition for Individual Accounts Below US\$50,000:** Accounts held by “U.S. persons” are not considered “U.S. accounts”—whether or not the account is a pre-existing account or a new account<sup>8</sup>—if the account:
    - i) Depository account (i.e. “a commercial, checking, savings, time, or thrift account, an account evidenced by a certificate of deposit or similar instruments, and any amount held with an insurance company under an agreement to pay interest.” See proposed Treas. Reg. § 1.1471-5(b)(1));
    - ii) In the name of a natural, physical person;

<sup>6</sup> Proposed Treas. Reg. § 1.1474-5(a)(2).

<sup>7</sup> See Proposed Treas. Reg. § 1.1471-4(e)(2).

<sup>8</sup> The preamble to the IRS’s proposed FATCA regulation specifically states that this exception to the U.S. account definition applies regardless of whether the account was in existence or not at the time FATCA comes into effect: “The same rules apply to both preexisting and new accounts”. 77 Fed. Reg. at 9033.



- iii) That is below US\$ 50,000 in value (multiple accounts held by the same individual at on financial institution must be aggregated) at the end of the calendar year or the date it is closed. If the account is denominated in currency other than U.S. dollars, the accounts value for purposes of the US\$ 50,000 threshold will be determined based on the currency’s spot rate relative to the U.S. dollar on the last day of the calendar year.
- **Collect IRS Form W-9 From Account Holder:** For “U.S. accounts” (i.e. ones held by U.S. citizens or U.S. residents that are above US\$50,000 in value) “participating FFIs” must in general collect an IRS [Form W-9](#) from the account holder.
- **What Information Must Be Reported about U.S. Accounts?** As proposed, information that must be reported to the IRS with respect to each U.S. account includes:
  - i) The name, address, and taxpayer identifying number (TIN) of each account holder who is a “specified U.S. person,” as defined below (or, in the case of an account holder that is a U.S. owned foreign entity, the name, address, and TIN of each specified U.S. person that is a substantial U.S. owner of such entity);
  - ii) The account number;
  - iii) The account balance or value; and
  - iv) The gross receipts and gross withdrawals or payments from the account over a specified time period to be set by the IRS.
- **Special Rules for Certain Types of Accounts:**
  - i) **Financial Accounts Held by Agents:** When an agent (such as a real estate agent) holds an account on behalf of a client (i.e. the “principal”) the principal and not the agent will be considered the holder of the account for FATCA purposes.
  - ii) **Jointly-Held Accounts:** Accounts that are held jointly by more than one account holder are “U.S. accounts” if any of the holders are “U.S. persons,” unless the account meets the exception for accounts below US\$ 50,000 discussed above.
  - iii) **Other Special Rules:** Proposed Treasury Regulation § 1.1471-5(a)(3) also contains additional special rules that are not likely to be relevant for credit unions concerning accounts held by “grantor trusts” (i.e. trusts where the trustee is the



settlor of the trust or a close relative of a settlor; “grantor trusts” do not receive favorable tax treatment under U.S. law) and some types of annuity and insurance contracts where the beneficiary of the policy/annuity can access cash value or change a beneficiary.

- **“U.S. Person” Definition:** Most FATCA requirements apply to the not-yet-taxed funds of “specified U.S. persons,” as defined below; however, the IRS definition of “U.S. person” is part of the “specified U.S. person” definition. Under IRS [Announcement 2010-16](#), the term “United States person” or “U.S. person” means: (1) a citizen or resident of the United States; (2) a partnership formed under U.S. law; (3) a corporation formed under U.S. law; or (4) an estate or trust formed under U.S. law.
  
- **“Specified U.S. Person” Definition under FATCA:** The term “specified United States person” (or “specified U.S. person”) under the proposed FATCA rules means any U.S. person, as defined immediately above, other than—
  - 1) A corporation the stock of which is regularly traded on one or more established securities markets;
  - 2) Any corporation that is a member of the same “expanded affiliated group” (as defined in section 9 of this Summary, below) as a publicly-traded corporation;
  - 3) Any organization exempt from taxation under [I.R.C. section 501\(a\)](#) (including U.S. credit unions) or an individual retirement plan as defined in [I.R.C. section 7701\(a\)\(37\)](#);
  - 4) The United States or any wholly owned agency or instrumentality thereof;
  - 5) Any State, the District of Columbia, any possession of the United States, any political subdivision of any of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing;
  - 6) Any bank as defined in [I.R.C. section 581](#);
  - 7) Any real estate investment trust as defined in [I.R.C. section 856](#);
  - 8) Any regulated investment company as defined in section 851 or any entity registered with the Securities Exchange Commission under the Investment Company Act of 1940 ([15 U.S.C. § 80a-64](#));
  - 9) Any common trust fund as defined in [I.R.C. section 584\(a\)](#);
  - 10) Any trust that is exempt from tax under [I.R.C. section 664\(c\)](#) or is described in [I.R.C. section 4947\(a\)\(1\)](#);
  - 11) A dealer in securities, commodities, or derivative financial instruments (including notional principal contracts, futures, forwards, and options) that is registered as such under the laws of the United States or any State; and
  - 12) A broker as defined in [I.R.C. section 6045\(c\)](#) and [Treasury Regulations § 1.6045-1\(a\)\(1\)](#).



- **“U.S. Resident” Definition:** The IRS has a test for determining whether a non-U.S. citizen (called an “alien” in U.S. tax law) is a “U.S. resident” for taxation purposes. This test is set forth in [Chapter 1](#) of IRS [Publication 519 \(“U.S. Tax Guide for Aliens”\)](#). Under U.S. law, a person can be considered a “U.S. resident” and also be a legal “resident” of another country at the same time. The concept of legal “residency” in the U.S. is contrasted with the concept of legal “domicile.” A person can have more than one legal “residence” at one time but can only ever have one “domicile” at a time.<sup>9</sup> In general, a non-U.S. citizen is a “U.S. resident” if he or she:
  - 1) Was or is a lawful permanent U.S. resident (i.e. has or had a “green card” during the relevant time period); or
  - 2) Meets the following two requirements:
    - a) Was physically present in the U.S. for at least 31 days during the prior calendar year; and
    - b) Was physically present in the U.S. for at least 183 days during the preceding 3-year period (i.e. during the three prior calendar years).
  
- **“Recalcitrant Accountholder” Definition:** “The term recalcitrant account holder means any account holder of an account maintained by a participating FFI if such account holder is not an FFI (or presumed to be an FFI), the account does not meet the exception to U.S. account status ... (applying to depository accounts with a balance of US\$ 50,000 or less) or does not qualify for any of the exceptions from the documentation requirements described in § 1.1471–4(c)(4)(ii), (iii), or (iv) (including if the participating FFI elects not to apply such exceptions), (c)(7), or (c)(9), and—
  - i. “The account holder fails to comply with requests by the participating FFI for the documentation or information that is required under § 1.1471–4(c) for determining the status of such account as a U.S. account or other than a U.S. account;
  - ii. “The account holder fails to provide a valid Form W–9 upon request from the participating FFI or fails to provide a correct name and TIN combination upon request from the participating FFI when the participating FFI has received notice from the IRS indicating that the name and TIN combination reported by the participating FFI (or a branch thereof in the case in which the

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<sup>9</sup> “Residence usually just means bodily presence as an inhabitant in a given place; *domicile* usually requires bodily presence plus an intention to make the place one’s home. A person thus may have more than one residence at a time but only one domicile.” *Black’s Law Dictionary* 1310 (7<sup>th</sup> ed. 1999).



branch reports the account separately under § 1.1471–4(d)(2)(ii)(C)) for the account holder is incorrect; or

- iii. (iii) “If foreign law would prevent reporting by the participating FFI (or branch or division thereof) of the information described in § 1.1471–4(d)(3) or (5) with respect to such account, the account holder (or substantial U.S. owner of an account holder that is a U.S. owned foreign entity) fails to provide a valid and effective waiver of such law to permit such reporting.”<sup>10</sup>

- **“Prime Facie” FFI:** As proposed by the IRS, a “prima facie FFI means any payee if—
  - 1) The withholding agent has available as a part of its electronically searchable information a designation for the payee as a “qualified intermediary” or “non-qualified intermediary,”<sup>11</sup> or
  - 2) For an account maintained in the United States, the payee is presumed to be a foreign entity, or is documented as a foreign entity for purposes of chapter 3 or 61 of IRS’s rules and regulations, and the withholding agent has recorded as part of its electronically searchable information a standardized industry code that indicates that the payee is a financial institution. The following North American Industry Classification System codes indicate that the payee is a financial institution:
    - i. Commercial Banking (NAICS 522110)
    - ii. Savings Institutions (NAICS 522120)
    - iii. Credit Unions (NAICS 522130)
    - iv. Other Depository Credit Intermediation (NAICS 522190)
    - v. Investment Banking and Securities Dealing (NAICS 523110)
    - vi. Securities Brokerage (NAICS 523120)
    - vii. Commodity Contracts Dealing (NAICS 523130)
    - viii. Commodity Contracts Brokerage (NAICS 523140)
    - ix. Miscellaneous Financial Investment Activities (NAICS 523999)
    - x. Open-End Investment Funds (NAICS 525910)
  - 3) In addition, the following Standard Industrial Classification Codes indicate that the payee is a financial institution:
    - i) Commercial Banks, NEC (SIC 6029)
    - ii) Branches and Agencies of Foreign Banks (branches) (SIC 6081)

<sup>10</sup> Proposed Treas. Reg. § 1.1471-5(g).

<sup>11</sup> “A nonqualified intermediary (NQI) is any intermediary that is a foreign person and that is not a qualified intermediary.” See the IRS webpage on [Foreign Intermediaries](#) for more information.



- iii) Foreign Trade and International Banking Institutions (SIC 6082)
- iv) Asset-Backed Securities (SIC 6189)
- v) Security & Commodity Brokers, Dealers, Exchanges & Services (SIC 6200)
- vi) Security Brokers, Dealers & Flotation Companies (SIC 6211)
- vii) Commodity Contracts Brokers & Dealers (SIC 6221)
- viii) Unit Investment Trusts, Face-Amount Certificate Offices, and
- ix) Closed- End Management Investment Offices (SIC 6726)

### **3) Non-U.S. Credit Unions as Partially-Exempt “Deemed Compliant” “Local FFIs” or (Possibly) “Nonregistering Local Banks”**

- **Most Non-U.S. Credit Unions Can Comply as “Deemed Compliant” “Local FFIs, and Possibly as “Deemed Compliant” “Nonregistering Local Banks:”**  
Most non-U.S. credit unions are likely to be able to comply with FATCA as one of two types of “deemed compliant” institutions: (A) “Local FFIs” that must register with the IRS; or (B) possibly as “nonregistering local banks” that are not required to register with the IRS, but only if the IRS amends the proposed definition of “nonregistering local bank” to include credit unions in the final version of the regulation (credit unions would not likely meet the proposed definition of “nonregistering local bank” because the proposed definition makes specific reference to banks as defined under I.R.C. § 581 and credit union are defined under a different section of the Internal Revenue Code, I.R.C. § 501(c)(1) and (c)(14)).

#### **A. “Deemed Compliant” “Local FFIs” That Must Register With the IRS:**

Under the proposed “Local FFI” rules—which are in proposed Treasury Regulation § 1.1471-5(f)—accounts held by “U.S. persons” who are residents of the credit union’s home country would be permitted (unless the “U.S. person” ceases to reside in the home country) and accounts below US\$ 50,000 would not be considered “U.S. accounts” even if held by a non-resident U.S. person. As proposed, most non-U.S. credit unions would be eligible to comply with FATCA under the “deemed compliant” FFI requirements as a “Local FFI” if the non-U.S. credit union:

- (1) Does not have a fixed place of business outside of its home country;
- (2) Does not solicit account holders outside its home country (a website would not be considered “soliciting” account holders outside the home country so long as the website does not specifically state that nonresidents may open accounts, does not advertise deposits in U.S. dollars or other U.S. dollar denominated investments, and does not target U.S. customers);



- (3) Has at least 98% of its accounts held by residents of the home country (which in the European Union (EU) includes residents of any EU country) – these local residents can also be U.S. citizens or U.S. residents so long as they have not ceased to be legal residents of the home country (in some cases a “certificate of residency” may be required);
- (4) Is licensed or regulated “under the laws of” a home country that is Financial Action Task Force (FATF) compliant with respect to AML regulation “as a bank or similar organization authorized to accept deposits in the ordinary course of its business, a securities broker or dealer, or a financial planner or investment advisor . . . ;”
  - ***Is My Country FATF Compliant?*** FATF is the international standard setting body for AML rules. More information on FATF can be found [here](#). Most countries should be considered compliant with FATF’s AML recommendations within the meaning of the FATCA regulation if the country is one of the [34 FATF member states or part of the 2 FATF regional associations](#), or if the country is a member of one of the FATF’s Associate Member organizations, which include the [Asia/Pacific Group on Money Laundering](#) (APG), the [Caribbean Financial Action Task Force](#) (CFATF), the [Eurasian Group](#) (EAG), [Eastern and Southern Africa Anti-Money Laundering Group](#) (ESAAMLG), the [Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism](#) (MONEYVAL), the [Financial Action Task Force on Money Laundering in South America](#) (GAFISUD), the [Inter Governmental Action Group against Money Laundering in West Africa](#) (GIABA), and the [Middle East and North Africa Financial Action Task Force](#) (MENAFATF).
- (5) Is required under the tax laws of the institution’s home country to file tax information returns regarding home country residents with its home country’s tax authorities and/or withholds tax for that authority; and
- (6) Adopts policies and procedures assuring it generally does not have accounts held by “specified U.S. persons” who are not residents of the home country or are above US\$ 50,000, and performs due diligence requirements as described below:



- ***Due Diligence Required by “Local FFIs:”*** According to the text of the proposed FATCA regulation, “Local FFIs” would be required to follow these due diligence procedures.
  - i. As part of this process, the credit union’s chief compliance officer or a similar executive would need to provide the IRS with a certification that the credit union meets all of the “Local FFI” requirements and would need to renew this certification every three years;
  - ii. “On or before the date it registers as a deemed-compliant FFI, the FFI must implement policies and procedures to ensure that it does not open or maintain accounts for any specified U.S. person who is not a resident of the country in which the FFI is organized (including a U.S. person that was a resident when the account was opened but subsequently ceases to be a resident), a nonparticipating FFI, or any entity controlled or beneficially owned (as determined under the FFI’s AML due diligence) by a specified U.S. person.”<sup>12</sup>
  - iii. “With respect to each account that is held by an individual who is not a resident of the country in which the FFI is organized or by an entity, and that is opened after December 31, 2011, and prior to the date that the FFI implements the policies and procedures described [under Roman number “ii” immediately above] the FFI must review those accounts in accordance with the procedures described in the “FFI agreement” rules proposed to be codified at Treas. Reg. § 1.1471–4(c) . . . as would be required if it were a participating FFI.”<sup>13</sup>
- **Registered “Local FFIs” are Partially Exempt:** “Deemed compliant” FFIs meeting the “Local FFI” would need to register with the IRS and file a due diligence certification with the IRS every three years, but would not likely have to engage in other periodic reporting to the IRS or home country government agencies, tax collection, or “due diligence” internal reviews and audits otherwise required by the proposed

<sup>12</sup> Proposed Treas. Reg. § 1.1471-5(f)(6).

<sup>13</sup> Proposed Treas. Reg. § 1.1471-5(f)(7).



rule (except for the due diligence requirements for “Local FFIs” summarized immediately above).

- **“FFI EIN” Number:** “Local FFIs” would receive a “foreign financial institution Employer Identification Number” (FFI EIN) for FATCA compliance purposes, and this unique identifier would be placed on an IRS list of institutions that are FATCA compliant (i.e. a “whitelist”) that participating FFIs would be required to check at least annually.
- **Effect of Failing to Register with the IRS:** If an otherwise “deemed compliant” credit union does not register with IRS, it would likely be subject to a 30% “withholding” tax on certain “withholdable payments,” as defined below—i.e. on funds that are generally attributable to U.S. income sources—when the transaction involves: (1) a U.S.-based financial institution; and/or (2) a non-U.S. FFI that has either: (a) an individual agreement with the IRS for FATCA compliance purposes; or (b) is located in a country that has entered into a FATCA-related tax treaty with the United States. In addition, a credit union that fails to register with the IRS could be blacklisted by major financial institution and the U.S. government as the equivalent of a “tax haven” financial institution.
- **Online Registration Process:** The IRS registration process will be an online, electronic form that is proposed to be available starting on January 1, 2013.

**B. “Deemed Compliant” “Nonregistering Local Banks” and That Do Not Have to Register with the IRS:** The proposed IRS definition of “nonregistering local bank” would not include credit unions because credit unions are not defined as “banks” under U.S. tax law. World Council will be urging the IRS to expand the definition of “nonregistering local bank” to include credit unions that otherwise meet the other proposed requirements for “nonregistering banks. As proposed, Treasury Regulation § 1.1471–5(f)(2) would define “nonregistering local bank” is as follows:

1. “The FFI must operate and be licensed solely as a bank (within the meaning of section 581, determined as if the FFI were incorporated in the United States) in its country of incorporation or organization and engage primarily in the business of making loans and taking deposits from unrelated retail customers.”



2. The FFI must be licensed to conduct business in its country of incorporation or organization and must have no fixed place of business outside such country.
  3. The FFI must not solicit account holders outside its country of organization. For this purpose, an FFI will not be considered to have solicited account holders outside of its country of organization merely because it operates a Web site, provided that the Web site does not specifically state that nonresidents may hold deposit accounts with the FFI, advertise the availability of U.S. dollar denominated deposit accounts or other investments, or target U.S. customers.
  4. “The FFI must have no more than [US]\$175 million in assets on its balance sheet and, if the FFI is a member of an expanded affiliated group, the group may have no more than \$500 million in total assets on its consolidated or combined balance sheets.”
  5. “The FFI must be required under the tax laws of the country in which the FFI is organized to perform either information reporting or withholding of tax with respect to resident accounts. An FFI that is not subject to such information reporting or withholding requirements will be considered to meet this requirement if all of the accounts maintained by the FFI have a value or account balance of \$50,000 or less, taking into account the account aggregation rules set forth in § 1.1471–4(c)(4).”
  6. “With respect to an FFI that is part of an expanded affiliated group, each FFI in the expanded affiliated group must be incorporated or organized in the same country and must meet the requirements set forth in this paragraph (f)(2)(i).”
- **What Would “Nonregistering Local Banks” Need to do to Comply with FATCA?** “Nonregistering local banks”—which could include credit unions under US\$ 175 million in assets if IRS expands the proposed definition of “nonregistering local bank” in its final version of the FATCA regulation—would not be required to register with the IRS. Instead, the “nonregistering local bank” would be required to provide “withholding agents” such as U.S. banks and internationally active non-U.S. commercial banks with:
    - a. A valid withholding certificate (such as an IRS Form W-8); and



- b. An audited financial statement or, if the institution does not have an audited financial statement, an unaudited financial statement.”
- o **“Nonregistering Local Bank” Certification Requirements As Stated by the IRS in Proposed Treas. Reg. § 1.174-3(d)(6)(i):** “A withholding agent may treat a payee as a nonregistering local bank if the withholding agent can reliably associate the payment with a valid withholding certificate that identifies the payee as a foreign entity that is a nonregistering local bank, the withholding certificate contains a certification by the payee that it meets the requirements to qualify as a nonregistering local bank under § 1.1471–5(f)(2)(i), and the withholding agent has either a current audited financial statement, or if the payee does not have an audited financial statement, an unaudited financial statement or other similar financial document for the payee that supports the payee’s claim that it is an FFI that operates solely as a bank (within the meaning of section 581, determined as if the FFI were incorporated in the United States) and does not contradict the payee’s claim that it is eligible for certified deemed compliant status as a nonregistering local bank. A withholding agent will have reason to know that a payee is not a nonregistering local bank if the withholding agent has knowledge that the payee operates in more than one country or the withholding agent can determine that the payee has assets in excess of \$175 million.”

#### **4) Non-U.S. Credit Unions That Do Not Meet the “Local” Exemptions**

- **Non-U.S. Credit Unions That Are Not “Deemed Compliant” FFIs Would Be Required to Become “Participating FFIs:”** As proposed, non-U.S. credit unions that do not meet the “deemed compliant nonparticipating local bank” or the “Local FFI” definition outlined above would be required to become “participating FFIs” and meet the following requirements:
  - 1) **IRS Registration and Reporting:** Be required to register with the IRS and also:
    - a) **FATCA-Related Tax Treaties:** If a country enters into a FATCA-related tax treaty with the United States—like France, Germany, Italy, Spain and the U.K. have done already—that country’s non-exempt credit unions (i.e. “participating FFIs”) could report their U.S. taxpayer account information to a home country supervisory authority instead of the IRS, likely by using existing AML reporting procedures;  
or



- b) **Direct Agreement with the IRS:** The non-exempt credit union would be required enter into an “FFI Agreement” with the IRS as a “participating FFI”—the requirements of the “FFI Agreement” are set forth in Proposed Treasury Regulation § 1.1471-4 (“FFI agreement.”)— that would involve promising to report periodically to the IRS information about U.S. taxpayer accounts (unless the accounts meet the “grandfather” exemption discussed below);
- 2) **“Grandfathered” Accounts Exemption:** As proposed, existing accounts as of January 1, 2013 at non-exempt credit unions (i.e. “participating FFIs”) with balances below US\$50,000 would not need to be reviewed or reported and some other types of accounts would also be “grandfathered” and not be subject to periodic reporting unless those accounts were to eventually exceed US\$ 1 million in value at the end of any calendar year.
- 3) **Additional Non-Exempt Credit Union Compliance Procedures:** In addition, non-exempt credit unions (i.e. “participating FFIs”) would need to:
- a) **Review of Existing Individual Accounts:** Most existing accounts with balances above US\$50,000 (as proposed, FFIs do not need to review accounts below US\$50,000 and can assume that these are not “U.S. accounts”) would need to be reviewed to determine whether the account holder has indicia of U.S. residency or citizenship, such as:
- i. The person has identified him- or herself as a U.S. resident;
  - ii. The person has a place of birth in the United States;
  - iii. The person has a U.S. address;
  - iv. The person has a U.S. telephone number;
  - v. There are standing instructions to transfer funds to an account located in the United States;
  - vi. A power of attorney or other signatory authority granted to a person with a U.S. address; or
  - vii. A U.S. “in care of” or “hold mail” address if that is the only address that the credit unions has for the account holder;



- b) **Can the Review Be Electronic?** A “participating FFI’s” review of accounts between US\$50,000 and US\$1 million can be based on its electronic records. No further search of records or contact with the account holder is required unless U.S. indicia are found through the electronic search, or the account later exceeds US\$ 1 million in value.
  - c) **Due Diligence:** Engage in “due diligence” concerning U.S. taxpayers’ accounts, such as by conducting internal reviews, audits, etc. of certain types of accounts on a regular basis;
  - d) **Closing Accounts:** Close the accounts of “recalcitrant” U.S. taxpayers (i.e. those who are attempting to avoid compliance with U.S. tax laws); and
  - e) **Acting as a “Withholding Agent” and Collecting Tax for the IRS:** “Withhold” and render to the IRS 30% of certain “withholdable payments” that the credit union transfers to U.S. taxpayers’ accounts and to FFIs that have not registered with the IRS and/or FFIs that have: (i) failed to enter into a required FATCA-related agreement with the IRS; and (ii) are not located in a country that has entered into a FATCA-related tax treaty with the United States.
- **“FFI EIN” Number:** “Participating FFIs” would receive a “foreign financial institution Employer Identification Number” (FFI EIN) for FATCA compliance purposes, and this unique identifier would be placed on an IRS list of institutions that are FATCA compliant (i.e. a “whitelist”).
  - **Failure to Comply Means “Nonparticipating FFI” Status:** As proposed—like for “deemed compliant” FFIs that fail to register with the IRS, discussed above—a non-exempt credit union that fails to comply with any of the above-referenced requirements would likely be considered a “nonparticipating FFI” (as discussed in section 2 of the Summary, above) be subject to restrictions including the 30% “withholding” tax on “withholdable payments” that involve: (1) a U.S.-based financial institution; and/or (2) a non-U.S. FFI that has either: (a) an individual agreement with the IRS for FATCA compliance purposes; or (b) is located in a country that has entered into a FATCA-related tax treaty with the United States.



## **5) U.S. Credit Unions**

- **U.S. Credit Unions are “Withholding Agents.”** Please see Section 6 of this Summary (“Withholding’ under FATCA”) below for a description of most of the FATCA-related requirements for U.S. credit unions.
  - **How Do I File FATCA Reports With the IRS?** In general, withholding agents under the FATCA rules must provide information to the IRS about the payee using a revised version of IRS [Form 1042-S](#) that will be released in the future and also file a withholding income tax return on a future version of IRS [Form 1042](#).
- **U.S. Financial Institutions and Non-Resident Alien Accounts:** The preamble to the IRS FATCA proposed rule states that IRS will be initiating a comprehensive rewrite of its Form 1099-INT non-resident alien tax reporting and withholding requirements in order to conform them to FATCA. These new requirements have not been proposed at this time but likely will be proposed before the end of 2012.
- **For U.S. credit unions, FATCA Applies to Members’ International Transactions Involving U.S.-Related Income that has Not Yet Been Subject to Income Tax Withholding:** As noted elsewhere in this Summary, a key definition—the definition of “foreign passthru payment”— regarding what types of income is subject to FATCA withholding has not yet even been proposed by the IRS. However, the general intent under FATCA is to only have FATCA withholding apply to U.S.-related income that is not otherwise subject to income tax withholding.
  - **Form W-2 Wages:** Therefore, income from wages paid to employees that have income tax withheld and who receive IRS Form W-2 would not be subject to FATCA withholding both because (1) the person’s employer has already withheld estimated federal personal income tax from the funds; and (2) the FATCA definition of “withholdable payment” focuses on investment and interest income rather than wages.
  - **Self-Employed and Form 1099s:** In contrast, income earned by self-employed persons (including partners in a partnership) or that is reported on an IRS Form 1099 are not typically subject to income tax withholding. However, the proposed definition of a FATCA “withholdable payment” would not generally apply to wages, as noted above, meaning that the self-employed may not be affected significantly unless the IRS amends the “withholdable payment” definition or includes wages in its not yet proposed definition of “foreign passthru payment.”



- **More Information:** For more information about what income is typically subject to withholding in the U.S. and the applicable IRS reporting forms, see section 7 of this Summary, below.
- **U.S. Credit Union Due Diligence Requirements:**
  - **Identification of Members' Foreign Accounts:** “Withholding agent” U.S. credit unions would in most cases be required in general to use information collected for AML purposes under Bank Secrecy Act “customer due diligence” and “know your customer” rules to determine each member’s status for FATCA compliance purposes (such as whether they are a “specified U.S. person,” as defined above) and whether the member has any “pre-existing” accounts held by FFIs (i.e. foreign accounts held prior to January 1, 2013) .
  - **Reporting of Members' Ownership of Foreign Companies:** Beginning as early as March 15, 2014, U.S. credit unions may be required to report to the IRS information about members’ status as substantial owners in “nonfinancial foreign entities,” as well as other information.

#### 6) “Withholding” under FATCA

- **In General: “Withholdable Payment” Under FATCA Means Income from Investments or Deposits That is Not Yet Subject to U.S. Income Tax “Withholding” that is Being Transferred Out of the U.S.:** In general, a “withholdable payment” would mean U.S.-related gross proceeds (i.e. “gross” meaning not yet subject to U.S. federal income tax withholding, as illustrated in the below examples) related to income from investments or deposits including the gross proceeds from the sale or other disposition of any property of a type which can produce interest or dividends from sources within the United States (such as the stock of a U.S. corporation). These types of income do not include wages and are called “U.S. Source FDAP income.”
  - **But “Withholdable Payment” Is Not Fully Defined in Proposal:** Although the proposed rule contains a proposed definition of what generally constitutes under FATCA a “withholdable payment” attributable to U.S. income sources that can be subject to the 30% “withholding”—the general concept is described immediately above—but the proposal connects the definition of “withholdable payment” to the concept of “foreign passthru payment” which, as discussed below, the proposed regulation does not include an exact definition of.



- **“Foreign Passthru Payment” Not Yet Defined:** The proposed rule does not contain the proposed definition of “foreign passthru payment” that “participating FFIs” would be required with withhold. Rather, the rule’s preamble states that the IRS plans in the near future to rewrite its regulations on Form 1099 reporting and non-resident alien withholding and reporting in order to conform those rules to FATCA, and presumably the “foreign passthru payment” requirements to FFIs will be proposed as well as this later date. Those with changes would be effective January 1, 2014 even though the IRS has not yet proposed them yet. It is possible that the definition of “foreign passthru payment” will be included in the IRS proposed rule on changes to the agency’s existing Form 1099 reporting and non-resident alien withholding and reporting regulations.
- **Withholding Agents:** U.S. credit unions and non-U.S. credit unions that are not “Local FFIs”—i.e. the relatively few non-U.S. credit unions that will not be able to meet the FATCA definition of a “Local FFI,” as discussed below in section 3 of the Summary—would be required by the proposed rule to act as “withholding agents” for the IRS and collect taxes for the agency.
  - 1) **“Withholding Agent” Definition:** The proposed general definition of “withholding agent” is “any person [including credit unions], U.S. or foreign, in whatever capacity acting, that has the control, receipt, custody, disposal, or payment of a withholdable payment.”
  - 2) **Withholding Agent Requirements:** If the rule is finalized as proposed, the following requirements would apply to U.S. credit unions and other “withholding agents:”
    - **What Documentation is Required to Determine a Member’s FATCA Status?** A “withholding agent” may generally rely on the tax classification of an individual for FATCA purposes that are listed by the individual on IRS [Form W-8](#) (such as an IRS [Form W-8BEN](#) “Certificate of Foreign Status of Beneficial Owner for United States Tax” Withholding”) and IRS [Form W-9](#)—or on an “intermediately withholding certificate” (which are similar to Form W-8)—if the withholding agent has no reason to know that the form is incorrect.
      - **Form W-8 and Form W-9 Will Be Updated:** The IRS plans to issue new versions of Form W-8 and Form W-9 before FATCA becomes effective in order to adding lines to these



forms to allow an individual to clearly establish his or her FATCA status on the form.

- **Other Documentation?** A “withholding agent” would be required to obtain additional information (i.e. in addition to a valid Form W-8 or Form W-9, etc.) about accounts over US\$50,000 if there is:
  - **Indicia of U.S Status:** More information, such as a “certificate of residence,” organizational documents, financial statements, etc., would be required if there is information about the payee that indicates a U.S. connection including:
    - The person has identified him- or herself as a U.S. resident;
    - The person has a place of birth in the United States;
    - The person has a U.S. address;
    - The person has a U.S. telephone number;
    - There are standing instructions to transfer funds to an account located in the United States;
    - A power of attorney or other signatory authority granted to a person with a U.S. address; or
    - A U.S. “in care of” or “hold mail” address if that is the only address that the credit unions has for the account holder;
  - **IRS Reports Info Is Incorrect:** In addition, the “withholding agent” would need to collect additional information about a payee if the IRS notifies the withholding agent that the person is a U.S. person, such as if the individual has filed with the IRS a [Report of Foreign Bank and Financial Accounts](#)



[\(FBAR\)](#) using IRS [Form 8938](#) (“Statement of Foreign Financial Assets”) or a similar FBAR form.

- **How Must I Retain This Documentation?** In general, a participating FFI must retain the original or certified photocopies of documentation for at least 6 years in the case of pre-existing accounts (or longer if the IRS requests an extension).
- **FFI-EIN Numbers Whitelist:** The IRS plans to publish a “whitelist” of FFIs that have registered with the IRS. Payments made to institutions are on the whitelist would not generally be subject to FATCA withholding. This list would include the FFIs’ “FFI-EIN” number that the FFI uses for IRS tax compliance identification. “Withholding agents” can rely on this database if they verify all whitelisted FFI-EINs that it has on file at least once a year (by checking the IRS database).
- **“Pre-Existing” versus “New” Accounts:** Different requirements will apply to an account depending upon whether the account is in existence prior to January 1, 2013 (“pre-existing accounts”) or not (“new accounts”). These requirements are discussed under the definition of “U.S. accounts” in section 2, above.
- **30% Withholding:** “Withholding agents” would be required in general to withhold 30% of a member’s “foreign passthru payments” that are “withholdable payments,” as defined above, and:
  - (i) Starting January 1, 2014, involve income from U.S. sources paid to “new” accounts held by FFIs that have not registered with the IRS or are otherwise not FATCA-compliant as well as on some types of “pre-existing” accounts; or
  - (ii) Starting January 1, 2015, are payments of the gross proceeds of U.S. income paid to FFIs that have not registered with the IRS or are otherwise not FATCA-compliant.
- **General Information and Examples of U.S. Tax “Withholding:”** For more information on what types of U.S. income are subject to withholding outside of FATCA—as well as information about applicable IRS reporting forms and links to the IRS instructions for those forms—see section 7 of this Summary (“General



Information and Examples of Income Tax ‘Withholding’ in the U.S. Federal Tax System”), below.

- **Withholding Exemptions:** Payments falling within one of the following proposed exemptions would not be subject to withholding:
  - **Lack of Knowledge or Control:** U.S. credit unions would not in general be required to withhold taxes on funds that it has no control over or custody of money or property owned by a payee or beneficial owner of a payment, or lacks knowledge of the facts giving rise to such payments.
  - **Transitional Exception to Withholding:** U.S. credit unions would not be required to withhold taxes on payments made before January 1, 2015 involving some types of FFIs that have not registered with the IRS. This exception would not apply, however, when the U.S. credit union would have reason to know that the payment is to an unregistered FFI based on, for example, IRS records (e.g., IRS databases, Forms W-8 or W-9, etc.) and/or if it meets the below definition of “prima facie’ FFI” based on other available information like the FFI’s North American Industry Classification System code (e.g., the code for a credit union is “NAICS 522130”) or Standard Industrial Classification Code (e.g., the code for a commercial bank that is not elsewhere classified is “SIC 6029”).
  - **Payments to FFI “Qualified Intermediaries:”** Payments to FFIs that have agreed with the IRS to be “[qualified intermediaries](#)” pursuant to Revenue Procedure 2000-12, 2000-4 I.R.B. 387, may not be subject to withholding by the U.S. credit union if the “qualified intermediary” has itself elected to serve as a “withholding agent” for the IRS.
  - **“Grandfathered Obligations:”** The proposed rule would exempt from withholding any payment involving an existing “obligation”—such as bonds, term deposits, credit facilities, certain life insurance policies, etc.—outstanding on January 1, 2013, and any gross proceeds from the disposition of such an obligation.
  - **“Exempt Beneficial Owners:”** Payments involving “exempt beneficial owners”—such as non-U.S. governments, territorial U.S. governments, international organizations, foreign central banks, certain retirement funds, and some other types of organizations—would not be subject to withholding.
  - **“Deemed-Compliant” FFIs:** Payments involving “deemed-compliant” FFIs that have registered with the IRS would not be subject to withholding



requirements; “deemed compliant FFIs” include “Local FFIs” that have registered with the IRS.

- **Payments to Financial Institutions in U.S. Territories:** Payments involving financial institutions chartered by U.S. territories under certain circumstances, such as if the territory financial institution is not primarily engaged in the business or investing, reinvesting, or trading (based on, for example, the financial institution’s charter documents or credit report).
- **Payments to Certain Other FFIs:** Special rules would apply to payments from U.S. credit unions to certain other FFIs, such as some types of partnerships and trusts.
- **Penalty for Failing to “Withhold” Taxes:** If a “withholding agent” (such as a U.S. credit union or a non-U.S. credit union that is not a “Local FFI”) fails to withhold income tax under FATCA when withholding should be required, the penalty is that the “withholding agent” must itself pay the IRS tax that should have been withheld plus interest and penalties.
- **What Form Do I Use to Report Taxes I Have Withheld?** In general, withholding agents under the FATCA rules must provide information to the IRS about the payee using a revised version of IRS [Form 1042-S](#) that will be released in the future and also file a withholding income tax return on a future version of IRS [Form 1042](#).<sup>14</sup>
- **How Long Do I Have to Send the IRS the “Withheld” Funds?** As proposed, “withholding agents” would be required to deposit taxes withheld under the FATCA rules with the IRS “promptly” using either wire transfers or the [IRS FIRE online system](#). These withholding rules are set forth in IRS [Publication 515](#) (“Withholding of Tax on Nonresident Aliens and Foreign Entities”). In some cases, the taxes may need to be deposited with the IRS within three business days.

## **7) General Information on Income Tax “Withholding” in the U.S. Tax System:**

- As noted above, withholding agents must report FATCA-related tax withholding to the IRS using revised versions of IRS Form 1042 and Form 1042-S that will be released in the future after this FATCA regulation is finalized. This section of the Summary includes more detailed information about tax withholding in the U.S. tax system, including information about the IRS Forms used to report income that has already been subject to income tax withholding (and therefore would not be subject to additional withholding under FATCA, such as in the case of employee wages

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<sup>14</sup> See proposed Treas. Reg. § 1.1472-1(e) (“Withholding on NFFEs.”).



reported on Form W-2) as well as the forms used to report income that is not subject to prior withholding (which are usually reported on versions of IRS Form 1099, unless a Form 1042-S has also been filed, as explained below).

- a) **Wages and Not the Focus of FATCA and Formalized Payrolls Already “Withhold” Estimated Income Tax:** Wages or salary earned by a U.S.-based employee of a company that are paid through a formalized payroll system are generally subject to withholding of federal, state, and/or local personal income tax, meaning that an estimated amount of U.S federal and personal income tax are withheld from the employee’s paycheck when the employee is paid.
- **FATCA Focuses on Income From Investments and Deposits:** In addition, FATCA primarily focuses on income earned from investments or deposits in its definition of “withholdable payment,” meaning that wages are not proposed to be subject to FATCA withholding as a general matter.
  - **IRS Form W-2:** In most cases, these employee wages that are subject to withholding at the time of disbursement would be reported by the employer to the individual, the IRS, and/or state and local authorities using IRS [Form W-2](#).
  - **Example of Income Tax Withholding by an Employer:** For example, if an employee who lives in a jurisdiction that does not have state or local income tax makes \$500 a week before taxes and the IRS’s estimated rate of federal personal income tax that the employee would owe is approximately 15% of his or her income, \$75 in federal personal income tax would be withheld from the employee’s paycheck. (The employee would be disbursed the remaining \$425, minus any additional deductions to help pay for the employee’s health insurance, retirement plan, or other employee benefits that are partially paid for by the employer.)
- b) **“Foreign Recipients” Subject to Withholding and IRS Form 1042-S:** Withholding of income tax at the time of funds disbursement can also apply when the recipient of the funds meets the IRS’s definition of “foreign recipient” and the entity disbursing the funds



withholds estimated taxes from the payment and provides IRS [Form 1042-S](#) to the recipient, the IRS, and/or state and local tax authorities.

- c) **Income Subject to Prior Withholding Is Not Subject to FATCA Withholding:** Wages and salary paid through this sort of formalized system—as well as an income disbursed to “foreign recipients” under the rules for IRS [Form 1042-S](#)—would presumably be exempt from this regulation’s definition of “withholdable payment” and “foreign passthru payment” and would not be considered “gross” income in U.S. taxation parlance.

2) **Examples of U.S. “Gross” Income Not Subject to “Withholding:”**

- a) **FATCA Significant of No Prior Tax Withholding:** U.S.-earned “gross” income that has not been subject to tax reporting and withholding (such as if the worker is paid in cash “under the table” in the informal economy), or income was reported on a version of IRS Form 1099 and was not subject to withholding pursuant to IRS Form 1042-S—as further explained below—may be subject to the FATCA regulation’s withholding requirements if the person who receives this income from U.S. sources then chooses to send an international electronic money transfer (such as a worker’s remittance).

- b) **Independent Contractor Income and/or Informal Sector Income:** Money earned by U.S.-based workers who are classified as “independent contractors” (and have their income reported to the employee, IRS, and/or state and local tax authorities using IRS [Form 1099-MISC](#)) and/or are employed in the informal sector (e.g., have wages paid in cash “under the table”) are not generally subject to withholding of personal income tax at the time it is disbursed to the worker by his or her employer, and therefore would theoretically be subject to withholding under FATCA if the rule is finalized as proposed.

- **FATCA Focuses on Income From Investments and Deposits:** As noted above, FATCA primarily focuses on income earned from investments or deposits in its definition of “withholdable payment,” meaning that wages are not proposed to be subject to FATCA withholding as a general matter.



- c) **Investments, Dividends, Interest, and Coop Patronage Distributions:** Similarly, dividends (reported on IRS [Form 1099-DIV](#)) and interest income (reported on IRS [Form 1099-INT](#)) earned in the U.S. as well as income from the sale of U.S. investments (reported on IRS [Form 1099-B](#)) or taxable patronage distributions from U.S. cooperatives (reported on IRS [Form 1099-PATR](#)) are not typically subject to income tax withholding at the time it is disbursed to the individual.
- d) **Exception: “Foreign Recipients” Subject to IRS Form 1042-S:** A notable situation where income tax withholding does occur in these circumstances is when the taxpayer is designated as a “foreign recipient” and the payer of the income withholds estimated tax and provides the taxpayer, the IRS, and/or state and local tax authorities with IRS [Form 1042-S](#).

## **8) Countries Entering into FATCA Tax Treaties with the United States**

The U.S. Treasury Department has also [jointly announced](#) with the governments of France, Germany, Italy, Spain, and the United Kingdom that they have entered into intergovernmental agreements (called “tax treaties” in this Summary) on the exchange of tax information for FATCA compliance, and more FATCA-related tax treaties with the United States are expected.

This means that credit unions in the United Kingdom and other countries that enter into FATCA-related tax treaties with the United States would likely still need to register with the IRS initially but would provide any additional required information about U.S. account holders to national or provincial authorities—instead of to the IRS—likely using AML reporting procedures.

It is possible that not all countries will enter into FATCA-related tax treaties with the United States, however, because Canada, China, Japan, and Switzerland have all [raised objections](#) to the U.S. law.

## **9) Group FATCA Compliance Option for Non-U.S. “Expanded Affiliated Groups” Involving Joint-Stock Company Subsidiaries**

- **Members of “Expanded Affiliated Groups” that are “Participating FFI Groups:”** Groups of joint-stock companies owned by a non-U.S. credit union or non-U.S. credit union association that can meet the IRS definition of “expanded affiliated group” have the option to agree to be a “participating FFI group” that reports to the IRS on a consolidated basis. In this situation, one member of the group (such as the credit union or credit union association that “owns” the other companies in the group under the IRS



definition) would provide FATCA-related information to the IRS on behalf of the group, and the other members of the group would be exempted from most FATCA requirements as “nonreporting members of participating FFI groups.”

- 1) **Application to U.S. Credit Unions and U.S. Credit Union Associations?** U.S. credit unions or U.S. credit union associations (and companies owned by U.S. credit unions or U.S. credit union association) are not likely eligible for the “expanded affiliated groups” definition because the definition of “includable corporation” for group reporting purposes excludes entities such as U.S. credit unions and U.S. trade associations that are tax-exempt under [section 501 of the Internal Revenue Code](#). See I.R.C. §§ [501](#); [1471\(e\)](#), [1504](#).
- 2) **Application to Non-U.S. National Credit Union Systems?** It is not likely that a non-U.S. national credit union association could meet the proposed definition of “expanded affiliated group” at the national federation level because:
  - a) The law and applicable IRS regulations are written for joint-stock companies that are owned top-down in a traditional holding company structure; and
  - b) It would be difficult for a national credit union association to meet the 50 percent voting power and 50 percent ownership requirement of the “expanded affiliated groups” definition because credit unions typically own the national credit union association (not the other way around) and because credit union “one-member, one-vote” rules would generally prevent the aggregation of 50 percent of a credit union’s voting power in one member.
- 3) **Definition of “Expanded Affiliated Groups:”** In general the term “affiliated group” means—
  - (a) 1 or more chains of “includable corporations” connected through stock ownership with a common parent corporation, but only if—
  - (b) The following two conditions are met:
    - (i) The common parent owns directly stock representing at least 50 percent of the total voting power and 50 percent of the total equity value in at least 1 of the other “includable corporations,” and
    - (ii) Stock meeting the 50 percent of the total voting power and 50 percent of the total equity value requirements) in each of the “includible



