Deloitte.
德勤

China | Tax & Business Advisory | 23 September 2015

Tax Newsflash

U.S. Extends FATCA Transition Rules and Modifies Other Rules

On September 18, 2015, the United States Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) announced that they intend to extend the time that certain FATCA transitional rules will apply. The notice also provides information on the exchange of information by Model 1 IGA jurisdictions with respect to 2014.

> **Observation** – The notice provides welcome relief to FFIs and withholding agents who continue to struggle with the obligations imposed by FATCA.

Withholding on Gross Proceeds and Foreign Pass-thru Payments

Withholding will apply after December 31, 2018 (extended from December 31, 2016), to gross proceeds from the sale or other disposition of any property if it is of a type that can produce interest or dividends that are U.S. source FDAP income.

Observation – Withholding on gross proceeds is the ultimate enforcement mechanism; however, it is becoming less necessary as compliance by financial institutions is becoming universal.

Withholding on foreign pass-thru payments made to a recalcitrant account holder or a non-participating FFI will not be required until after December 31, 2018 (extended from December 31, 2016), or the date of publication in the Federal Register of final regulations defining the term foreign pass-thru payment, if later.

Observation – No one, including the U.S. Treasury and IRS, would like to see withholding apply to foreign pass-thru payments. The rules for defining a pass-thru payment are expected to be enormously complex, and administratively burdensome to implement. U.S. Treasury officials have said in the past that withholding on foreign pass-thru payments may not be narrowed if there is widespread compliance with FATCA. Some U.S.-based financial institutions have made the enhancements necessary to account for foreign pass-thru payments; however, few financial institutions headquartered in Asia except those which are qualified intermediaries have done so.

Sponsored Entity Registration Extended

The IRS has been developing a streamlined process for sponsoring entities to register their sponsored entities on the FATCA registration website. The IRS stated that it anticipates this registration process will be available in the coming months and intends to update the FATCA registration user guide to include this process. However, in order to provide sufficient time for sponsored entity registration, sponsoring entities will generally have until the end of 2016 (extended from the end of 2015), to register their sponsored entities.

Observation – Sponsored entities are not required to register and may continue to provide the GIIN of their sponsoring entity until the end of 2016.

Limited Branches and Limited FFIs Status Extended

There continue to be jurisdictions that have not been able or willing to agree to an IGA and that continue to impose legal restrictions that prevent FFIs resident or organized there, or branches located there, from complying with the terms of an FFI agreement. The availability of limited branch and limited FFI statuses will not terminate until January 1, 2017 (extended from January 1, 2016).

Observation – This will provide jurisdictions additional time to enter into an IGA or to modify their domestic laws to allow FFIs not covered by an IGA to maintain participating or deemed-compliant FFI status.

Observation – FFIs and branches that continue to operate after December 31, 2016, in jurisdictions where they cannot comply with the terms of an FFI agreement due to local law will jeopardize the status of FFIs (other than FFIs covered by an IGA) in the group.

Action Item – After December 31, 2015, all limited FFI and limited branch registrations will be placed in "registration incomplete" status on their online FATCA account. Limited FFIs and limited branches that seek to continue such status during the 2016 calendar year will be required to edit and resubmit their registrations after December 31, 2015, on the FATCA registration website.

Information Exchange may be deferred under Model 1 IGAs

Model 1 IGAs for which the Obligation to Exchange Has Not Taken Effect (Notice Section VII(A))

Treasury will continue to treat FFIs covered by a Model 1 IGA as complying with, and not subject to withholding under, FATCA, if the IGA has not yet entered into force on September 30, 2015. In such a case, the partner jurisdiction must continue to demonstrate firm resolve to bring the IGA into force and any information that would have been reportable under the IGA on September 30, 2015, must be exchanged by September 30, 2016, together with any information that is reportable under the IGA on or before September 30, 2016.

Observation – This will apply to all partner jurisdictions that have signed or agreed in substance to a Model 1 IGA. This does not affect the time when FFIs should report information to a partner jurisdiction as this is governed by local law.

Model 1 IGAs for which the Obligation to Exchange Is in Effect (Notice Section VII(B))

An IGA requires the partner jurisdiction to exchange information on U.S. reportable accounts with respect to 2014 by September 30, 2015, in the case of Model 1B IGA jurisdictions that have an IGA in force,[1] and Model 1A IGA jurisdictions for which the obligation to exchange information has taken effect.[2]

The Treasury and IRS recognize that partner jurisdictions may not have information exchange systems in place by September 30, 2015. In addition, several partner jurisdictions are in the

process of enacting legislation to implement their IGAs, without which they are not able to exchange information with the United States.

Calendar years 2014 and 2015 are regarded as a transition period for purposes of IRS enforcement and administration of the due diligence, reporting, and withholding provisions under FATCA. Consistent with treating 2014 and 2015 as a transition period, FFIs covered by an IGA will be treated as complying with, and not subject to withholding under, FATCA even if the relevant partner jurisdiction has not exchanged 2014 information by September 30, 2015, as long as the partner jurisdiction notifies the U.S. competent authority before September 30, 2015, of the delay and provides assurance that the jurisdiction is making good faith efforts to exchange the information as soon as possible. This does not affect the time when FFIs should report information to a partner jurisdiction as this is governed by local law.

> **Action Item** – In this case, FFIs will continue to be treated as covered by an IGA if an exchange of information has not occurred by September 30, 2015, but only if the partner jurisdiction notifies the U.S. competent authority before September 30, 2015, of the delay in exchanging 2014 information, and provides assurance that the jurisdiction is making good faith efforts to exchange the information as soon as possible.

Effect of Sections VII(A) and (B) of the Notice on Asia Pacific Jurisdictions

Country	IGA Type	In force	Signed	Agreed in substance
Cambodia	1			[A]
China	1			[A]
Indonesia	1			[A]
Indonesia	1			[A]
Malaysia	1			[A]
Thailand	1			[A]
Hong Kong	2		N/A	
Japan	2	N/A		
Macao	2			N/A
Taiwan	2			N/A
Australia	1A	[B]		
India	1A	[B]		
Korea	1A		[A]	
Mauritius	1A	[B]		
New Zealand	1A	[B]		
Philippines	1A		[A]	
Singapore	1B	[B]		
Laos	N/A			
Myanmar	N/A			
Vietnam	N/A			

[A] Jurisdiction may be affected by section VII(A) of the notice. Exchange of information may be deferred until September 30, 2016.

[B] Jurisdictions having a Model 1 IGA may be affected by section VII(B) of the notice. Exchange of information may be deferred if the partner jurisdiction notifies the U.S. competent authority by September 30, 2015.

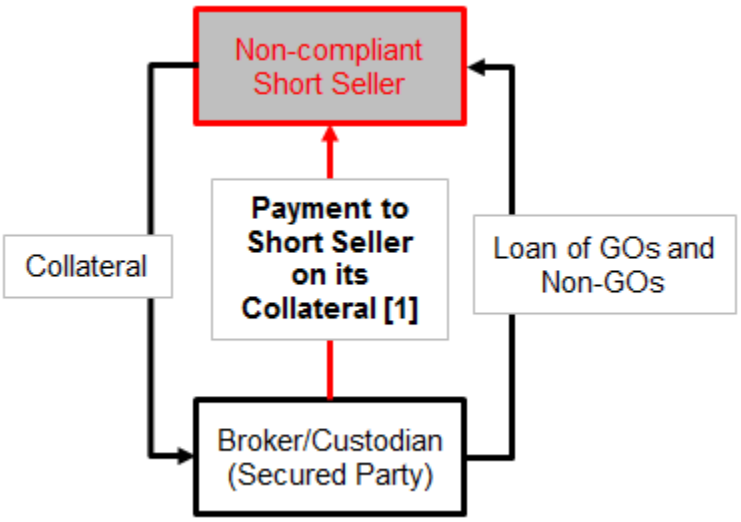
N/A: Jurisdiction is subject to a Model 2 IGA and not affected by section VII of the notice.

Use of Grandfathered Obligations as Collateral

A withholdable payment does not include a payment made under a grandfathered obligation. In addition, in order to reduce compliance burdens on withholding agents that hold collateral as a secured party, the rules for grandfathered obligations in relation to collateral will be modified by Treasury and the IRS.

Non-compliant Short Sellers

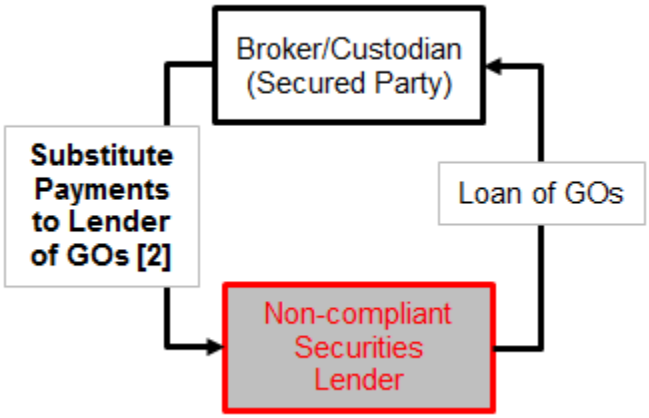
The notice provides that where collateral (which would often be posted by a short seller) secures both grandfathered obligations (GOs) and obligations that are not grandfathered (non-GOs), the secured party will be permitted either to withhold on all collateral or to apply the pro rata approach with respect to such collateral. Thus, the pro rata rule will no longer be mandatory. The diagram, below, illustrates the payment noted as [1] where the allocation would have been mandatory, but is now optional if withholding is applied to the full payment.



Observation – Making the pro rata rule optional will reduce administrative burdens imposed on secured parties, and allow a secured party to withhold on all collateral rather than applying the pro rata approach. This simplifies the characterization of payments.

Non-compliant Securities Lenders

The notice provides that a substitute payment made with respect to a grandfathered obligation that has been posted as collateral will be treated as a payment made under a grandfathered obligation, and not subject to withholding. The definition of grandfathered obligation will include any obligation that gives rise to substitute payments and that is created as a result of the payee posting collateral that is otherwise treated as a grandfathered obligation. The diagram, below, illustrates the payment noted as [2] which will be treated as if made with respect to a grandfathered obligation.



Observation –Without a rule to cover these substitute payments, it would be difficult to determine the proper treatment of collateral that is itself a grandfathered obligation, as collateral is frequently rehypothecated and the secured party cannot readily determine which collateral was rehypothecated (giving rise to substitute payments to the payee) and which collateral has been retained. This exception provides welcome relief to an almost impossible accounting requirement.

[1] Under article 10(1) (Model 1B IGA, Non-Reciprocal, Preexisting TIEA or DTC) or Article 12(1) (Model 1B IGA, Non-Reciprocal, No TIEA or DTC), a Model 1B IGA enters into force on the date of the partner jurisdiction's written notification to the United States that it has completed its necessary internal procedures for entry into force of the IGA.

[2] Under Article 3(9) of the Model 1A IGA, the obligations to obtain and exchange information take effect on the later of the Article 3(8) written notifications from each of the Competent Authorities. Under Article 10(1), a Model 1A IGA enters into force on the date of the partner jurisdiction's written notification to the United States that it has completed its necessary internal procedures for entry into force of the IGA.

If you have any questions please contact:

Hong Kong

Patrick Yip
FATCA Country Leader
Tax & Business Advisory Services
Deloitte China
+ 852 2852 1618
patyip@deloitte.com.hk

Jim Calvin
Managing Director
Financial Services Tax
Deloitte AP ICE, Ltd
+ 852 2238 7426
jimcalvin@deloitte.com

Sharon Lam
Tax Partner
Tax & Business Advisory Services
Deloitte China
+ 852 2852 6536
shalam@deloitte.com.hk

Candy Chan
Tax Partner
Tax & Business Advisory Services
Deloitte China
+ 852 2852 5886
cancha@deloitte.com.hk

Shanghai

Justin Zhu
Tax Partner
Tax & Business Advisory Services
Deloitte China
+ 86 21 61411139
juszhu@deloitte.com.cn

Johnny Foun
Tax Partner
Tax & Business Advisory Services
Deloitte China
+ 86 21 61411032
jfoun@deloitte.com.cn

Beijing

Natalie Yu
Tax Partner
Tax & Business Advisory Services
Deloitte China
+ 86 10 85207567
natyu@deloitte.com.cn

35/F One Pacific Place
88 Queensway
Hong Kong