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# FATCA: Assessing the impact on non-US companies

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## The FATCA effect is being felt around the world

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On 1 July 2014 the withholding provisions of the Foreign Account Tax Compliance Act (FATCA) took effect. Although a US law, FATCA is having a substantial impact on companies outside the US ('non-US companies'). For example:

- FATCA requires US companies making certain types of payments to non-US companies to withhold 30% of the payment unless the non-US company provides the US company with documentation regarding its FATCA status.
- FATCA requires non-US financial institutions (Foreign Financial Institutions or FFIs) to implement procedures to identify and report on account holders that are US citizens or residents. FFIs have recently been requiring many of its account holders provide new types of documentation.
- FATCA will soon require that non-US companies withhold 30% of gross proceeds from the sale of assets which give rise to US-source dividend or interest income (e.g. stock of a US company or US debt obligations).

On the whole, FATCA readiness for non-US companies means being prepared to respond to requests for various documents and information. This may involve collecting and analysing data from many entities throughout a multinational affiliated group. As this can take a lot of time and resources, non-US companies should act now rather than being caught unprepared and face a potential 30% withholding on payments from the US.

## FATCA overview

FATCA is triggered when someone (usually a US company) makes what is known as a 'withholdable payment' to a non-US company. In order for a payment to be 'withholdable' it must:

1. be sourced to the US
2. be a payment for what is known as Fixed or Determinable Annual or Periodical (FDAP) income.

FDAP income is a very broad category that includes virtually every type of income other than capital gains from the disposition of property. Examples of withholdable payments include payments of US source interest, royalties, dividends, rents and premiums for insurance contracts.

Although the definition of withholdable payment under FATCA can be very broad, there are several types of payments which are outside FATCA's reach. The largest category is 'excluded nonfinancial payments', which covers certain payments made within the ordinary course of business. .

Examples of excluded nonfinancial payments include payments for the following:

- services, including wages and other forms of employee compensation
- use of property
- office and equipment leases
- software licenses
- interest on outstanding accounts payable arising from the acquisition of goods and services.

*"FATCA aims to stop tax evasion by US taxpayers who are earning unreported income through accounts held directly or indirectly through foreign companies."*

Importantly, most payments of 'passive' income (such as dividends and interest not described on the previous page) will not qualify as excluded nonfinancial payments. However, an exception may apply for interest paid under certain debt instruments known as 'grandfathered obligations' that were outstanding on 1 July 2014, have a fixed term, and have not been materially modified after this date.

If a payment is a 'withholdable payment' and no exceptions apply, the payor (also called the 'withholding agent') must get information from the payee that contains the payees' FATCA status. If the payee doesn't give this, the withholding agent is required to withhold 30% of the withholdable payment and remit it to the US tax authorities.

## FATCA and 'traditional' withholding

The aim of traditional US withholding is to collect tax on nonresidents who are not engaged in business in the US but earn FDAP income sourced to the US. The US has a domestic withholding rate of 30% but this rate is often reduced under a tax treaty with the non-US recipient's home country. For example, the payment of dividends by a US subsidiary to a foreign parent may be eligible for a lower dividend withholding rate provided in the income tax treaty between the US and the foreign parent's country of residence.

In contrast, FATCA withholding was not designed to be a 'tax' on income. Instead, FATCA aims to stop tax evasion by US taxpayers who are earning unreported income through accounts held directly or indirectly through foreign companies. FATCA does this by using a withholding tax mechanism to encourage foreign companies to report information about their US account holders and/or US owners. An income tax treaty between the US and the foreign parent's country of residence therefore would not apply to reduce FATCA's 30% withholding rate.

FATCA rules must be applied before the traditional withholding rules. For example, a US subsidiary that makes an interest payment to a foreign parent will first need to determine whether a 30% withholding is required under FATCA. If the US subsidiary decides that a FATCA withholding is not required (if, for example, the interest payment was made following a grandfathered obligation as mentioned above), the US subsidiary would then need to decide whether the payment is subject to traditional US withholding tax and if the foreign parent would qualify for a reduced rate of withholding under the relevant income tax treaty. Ultimately, only one withholding tax (FATCA or traditional) will apply.

## How will non-US companies feel the impact?

FATCA has a broad reach. It can affect a non-US company as well as its US and non-US subsidiaries in a number of ways.

**Non-US companies may need to determine and provide documentation to support their FATCA classification.**

FATCA divides payees into two categories - FFIs and Non-Financial Foreign Entities ('NFFEs'). Most FFIs are banks that are involved in depository, custodial or investment activities - however holding companies, treasury centres and insurance companies can also be FFIs in certain circumstances. NFFEs, on the other hand, are all entities that are not FFIs.

### *Pathways to compliance*

FFIs and NFFEs have different paths to achieve FATCA compliance and documentation. If the payee is an FFI, the path is generally longer and depends on whether the FFIs' country of residence has an Intergovernmental Agreement (IGA) with the US and the IGA type. FFIs will generally need to register with the US tax authorities and will receive a Global Intermediary Identification Number (GIIN) to include with their FATCA documentation.

Over 80 countries have entered into (or agreed to enter into) what is called a 'Model 1 IGA' with the US. Under a Model 1 IGA, FFIs resident in the non-US country will need to share certain information about its US accounts to its local government, which will then share information to US authorities.

Alternatively, over ten countries have entered into (or agreed to enter into) a 'Model 2 IGA' with the US. This means that FFIs resident in the non-US country must report information about their US accounts directly to US authorities.

FATCA compliance and documentation for NFFEs is significantly less complex than for FFIs. NFFEs can comply with FATCA in one of two ways. First, an NFFE can provide information to the withholding agent that either shows its 'substantial US owners' (generally a US person that directly or indirectly own more than 10% of the NFFE) or shows that is has no substantial US owners. Second, an NFFE can determine whether it qualifies for an exception from FATCA withholding.

Two of the most common exceptions are the exception for publicly traded corporations (including certain affiliates) and the exception for 'Active NFFEs'. The former exempts corporations (and certain affiliates) who trade stock regularly on one or more established securities markets within the calendar year.  The latter exempts an NFFE if less than 50% of its gross income from the previous year is passive and less than 50% of the weighted average percentage of the assets held are for the production of passive income (tested quarterly).

Since cash and, in certain circumstances, stock in subsidiaries are viewed as passive assets, the active NFFE test can sometimes be difficult to meet. Both the publicly traded corporation exception and the active NFFE exception require the NFFE to apply US tax rules to determine whether the NFFE meets the test.

Once FATCA status is determined, both FFI and NFFEs provide documentation to the withholding agent. In most cases, the withholding agent requires the FFI or NFFE to provide the newly revised 'Form W-8BEN-E'.

### US subsidiaries of non-US companies may have new documentation and withholding requirements

As above, FATCA requires that US payors withhold 30% on withholdable payments from foreign entities who do not comply with FATCA documentation requirements. Therefore US subsidiaries of non-US companies may be required to obtain documentation from foreign payees and, if no documentation is provided, withhold payments.

Importantly, there are no general exceptions from FATCA documentation and withholding requirements for withholdable payments made to a related party. For example, FATCA might potentially apply to a dividend payment from a US subsidiary to its foreign parent, or interest payments made to a non-US sister corporation.

Non-US entities receiving payments from withholding agents should be prepared to provide documentation of FATCA status. Further, US subsidiaries of non-US companies will need to determine whether they are making 'withholdable payments' under FATCA and, if so, whether they the necessary documentation from payees or are otherwise withholding 30%.

## How can Grant Thornton help

As you may have gathered, FATCA is complicated. Grant Thornton’s global network of member firms has the experience and insight needed to help non-US companies understand and manage potential FATCA issues.

Non-US companies receiving payments from withholding agents should be prepared to provide documentation of FATCA status. Further, US subsidiaries of non-US companies (and, in some cases, the non-US companies themselves) will need to determine whether they are making 'withholdable payments' under FATCA and, if so, whether they have the necessary documentation from payees or are otherwise withholding 30%.

We can work with you to determine the FATCA status of entities within your multinational group and assist in your compliance with FATCA requirements. We can also work with you to determine which payments will be subject to FATCA withholding and ensure that your company fulfills the new documentation and withholding requirements. This may require a review and analysis of your accounting systems' ability to capture the relevant information as well as improving processes and procedures to ensure compliance.