

MEMO# 31525

December 18, 2018

IRS Issues Proposed Regulations to Ease FATCA Withholding Rules

[31525]

December 18, 2018 TO: ICI Members

ICI Global Tax Committee

Tax Committee

Transfer Agent Advisory Committee SUBJECTS: FATCA

Tax RE: IRS Issues Proposed Regulations to Ease FATCA Withholding Rules

On December 13, 2018, the IRS issued [proposed regulations](#) modifying the “Chapter 4” withholding requirements implementing the 2010 legislation known as “FATCA.”^[1] These regulations will eliminate withholding on payments of gross proceeds and on some insurance premiums, defer withholding on foreign passthru payments, and clarify the definition of investment entity. The regulations also provide guidance on some due diligence requirements of withholding agents and on refunds and credits of amounts withheld. The guidance most relevant to regulated investment companies (RICs) is summarized below.

Elimination of Withholding on Gross Proceeds

The proposed regulations will eliminate the FATCA requirement to impose withholding tax on gross proceeds; the Treasury Department previously delayed withholding on gross proceeds until January 2019. The gross proceeds withholding requirement will be eliminated because the Treasury Department has determined that the current withholding requirements under Chapter 4 on US investments already serve as a significant incentive for foreign financial institutions (FFIs) investing in US securities to avoid status as nonparticipating FFIs. As a result, only certain payments of US source fixed or determinable, annual or periodical (FDAP) income, such as dividends, will be subject to FATCA withholding.

Deferral of Withholding on Foreign Passthru Payments

The proposed regulations also provide that a participating FFI will not be required to withhold on foreign passthru payments made to a recalcitrant account holder or nonparticipating FFI until two years after final regulations define the term “foreign passthru payment.” The Treasury Department and IRS noted that withholding on foreign passthru payments serves important purposes and that they will continue to consider the feasibility of a system implementing withholding on such payments.

Definition of Investment Entity

The proposed regulations clarify that an entity is not “managed by” another entity—and therefore is not itself a financial institution for FATCA purposes—solely because the first-mentioned entity invests all of a portion of its assets in such other entity, and such other entity is a mutual fund, an exchange traded fund, or a collective investment vehicle that is widely held and is subject to investor-protection regulation. In contrast, an investor in a discretionary mandate^[2] is “managed by” a financial institution. This clarification is similar to the OECD’s guidance interpreting the definition of a “managed by” investment entity under the Common Reporting Standard.

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endnotes

^[1] “FATCA” is the acronym for “Foreign Account Tax Compliance Tax.” See Institute Memorandum No. [24186](#), dated March 17, 2010. The “Chapter 4” withholding taxes of IRC sections 1471 *et seq* (that implement FATCA) are designed to enforce reporting on certain foreign accounts. The “Chapter 3” withholding taxes of IRC sections 1441 *et seq*, in contrast, are imposed on nonresident aliens and foreign corporations with respect to certain investments in the United States.

^[2] A “discretionary mandate” is an investment product or solution offered by a financial institution to certain clients whereby the financial institution manages and invests the client’s funds directly (rather than the client investing in a separate entity) in accordance with the client’s investment goals.