

Often Overlooked Exception to Withholding and Reporting Requirements under FATCA

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An often overlooked exception to U.S. withholding taxes may result in a lower overall U.S. tax burden.

The Foreign Account Tax Compliance Act (“FATCA”) was enacted in an effort to ensure that U.S. taxpayers could not avoid U.S. federal income tax on investment income through the use of non-U.S. accounts or entities. FATCA requires that certain foreign financial institutions (“FFIs”) and nonfinancial foreign entities (“NFFEs”) comply with information reporting requirements intended to identify U.S. account holders or U.S. owners. FFIs generally include banks, investment companies or similar financial institutions, and certain non-U.S. trusts while NFFEs generally include any entity that is not a financial institution.

Under FATCA, a withholding agent that does not obtain proper documentation from its beneficial owners as required for compliance with applicable FATCA reporting requirements (e.g., an IRS Form W-9, W-8BEN, W-8BEN-E or other applicable form) is generally required to withhold 30% of a withholdable payment to an FFI or NFFE. For these purposes, a “withholdable payment” is defined as (i) any payment of interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income (collectively, “FDAP Income”), if such payment is from sources within the United States, and (ii) any 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 (e.g., capital gains of stock of a U.S. corporation).

However, in December of 2018, Treasury issued Proposed Regulations which would remove gross proceeds from the definition of a “withholdable payment”, and thereby eliminate the withholding requirements on gross proceeds described in (ii) above. The Preamble to the Proposed Regulations noted that financial institutions faced significant administrative burdens in complying with such withholding requirement for gross proceeds and that it was no longer necessary given widespread compliance with the

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FATCA regime.

While these Proposed Regulations have yet to be finalized, the Preamble provides that taxpayers may generally rely on the Proposed Regulations until such time that final Treasury Regulations are issued. Accordingly, only payments of U.S.-source FDAP Income are currently subject to FATCA withholding and reporting requirements.