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# Foreign Account Tax Compliance Act: IRS Notice 2011-34

## Introduction

In April 2011 the US Treasury and the IRS have published the notice 2011-34. It is the second notice that deals with the FATCA-guidelines, rules and their implementation. In this newsletter we will provide an overview of the main topics of notice 2011-34 and some more detailed information about the topic of „passthru payments“, an important issue that has barely been mentioned in the first FATCA-notice 2010-60.

## Contents of IRS Notice 2011-34

The IRS Notice 2011-34 contains guidance on the following issues:

- Refinements to the requirements on how „Participating FFI's“ (called „PFFI“ in the following) have to identify "US Accounts" among their existing relationships with natural persons
- Application of the „passthru payment“ rules, which require PFFI's to perform withholding on payments to customers who have not provided information about their US status (recalcitrant account holders and FFI's that have not entered into a FATCA-agreement with the IRS)
- FFI's that will be deemed to be in compliance with the FATCA-rules without entering into an agreement with the IRS
- Reporting obligations of PFFI's with respect to „US Accounts“
- Interaction between the FATCA-rules and the „qualified intermediary“ (QI) rules
- Application of FATCA-rules in the case of affiliated PFFI's
- Effective date of FATCA-agreements

According to the rules of notice 2011-34, it is no longer mandatory to review the documentation of pre-existing individual retail banking accounts. The differentiation between retail banking and private banking is not based on the assets under management of the respective clients, but rather the kind of customer relationship management and the organizational classification of the respective business area at the PFFI. The rules regarding pre-existing private banking accounts have been substantially expanded, which will cause considerable additional expenses in managing client relationships in private banking, while alleviations for the retail banking accounts are provided on the other hand.

## Passthru payments

The notice 2011-34 comprises numerous rules regarding „passthru payments“. A passthru payment is any „withholdable“ payment according to the rules laid out in US tax code section 1471(d)(7). A „withholdable“ payment according to these rules is any payment, which is being made by a PFFI to a recalcitrant account holder or an FFI not having entered into an agreement with the IRS to the extent that such a payment is attributable to a withholdable payment.

The IRS rejects all requests to limit the "passthru payment" rules to payments somehow directly traceable to underlying US assets, because such requests are viewed as contrary to congressional intent. Instead all payments are treated as subject to withholding to the extent that the FFI's assets give rise (or could give rise) to withholdable or passthru payments.

The core element of the „passthru payment“ system is the concept of the „passthru payment percentage“ (called "PPP" in the following), i.e. the percentage of an FFI's assets that are classified as US assets.

The intentions of the IRS regarding „passthru payments" are being discussed intensely in the financial industry at the moment. For this reason we like to illustrate the topic with two examples in the following:

1. A recalcitrant account holder owns shares of the XY bank and receives a dividend payment (a PFFI acting as custodian). At disbursement of the dividend to the client the bank has to retain the „PPP" of the issuer of the share and compute the dividend payment portion subject to the withholding rate of 30%.
2. A recalcitrant client has a savings account at a PFFI and receives an interest payment. The interest payment is subject to withholding respecting the PFFI's own "PPP".

The notice 2011-34 contains extensive regulations concerning the kind and frequency of the „PPP" calculation. A PFFI for example has to calculate and communicate its „PPP" on a quarterly basis. In the absence of such communication, a percentage of 100% is to be assumed.

**Implications of the „passthru payment" rules**

The implications of the „passthru payment" rules are not yet clear for all affected areas. The rules concerning investment funds and insurance policies need further clarification. Business transactions between FFI's are affected by these rules to a large extent. This is not only valid for repo transactions, but also for other money market transactions and the processing of any payment. For a non-participating FFI the access to the interbank market will be strongly hindered or even made impossible. If for example a non-participating FFI uses a PFFI as correspondent bank for the processing of its payments, this bank has to anticipate a withholding to the extent of the „PPP" of the correspondent bank on all incoming payments. The main goal that the IRS tries to achieve with FATCA becomes obvious also with the definition of the „passthru payment" rules: to get as many FFI's as possible entering into a FATCA-agreement and to extend the tax base to the possible maximum. Complaints about high implementation costs and administration effort required play a marginal role at the most. The rules make it also clear that FFI's who implement FATCA will be facing complex and challenging tasks.

The combination of tax-, business- and IT-know-how enables Banking Concepts to support financial institutions implementing regulatory requirements such as FATCA and to offer them real added value.

The next FATCA newsletter will be published in October 2011.

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