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## FATCA documentation for disregarded entities Kozusko Harris Duncan | Private Client & Offshore Services - USA

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### **Introduction**

The Foreign Account Tax Compliance Act (FATCA) requires entity account holders to document their status for US withholding tax purposes (Chapter 3 status) and their status for FATCA due diligence purposes (Chapter 4 status). In the case of a non-US entity account holder that has made an entity classification election (the so-called 'check-the-box election') to be disregarded for US income tax purposes, advisers to international families and their succession planning structures should carefully consider the instructions to the W-8 forms and provide the documentation for the disregarded entity's beneficial owner.

### **FATCA due diligence**

The financial institution requesting the status documentation uses it to determine whether, upon paying US source income to the account, it has a responsibility to withhold tax and file Form 1042-S with the Internal Revenue Service (IRS). US withholding tax is levied on certain US source

income paid to non-US individuals and entities (for further details please see the Overview (May 2014)). The financial institution is also requesting the documentation because once the entity account holder has complied, there is no need for the requester to withhold a FATCA penalty from the payment of any US source income. Even financial institutions that do not make US withholdable payments will request a self-certification form documenting an entity account holder's Chapter 3 and Chapter 4 status in order to comply with intergovernmental agreement (IGA) due diligence obligations for identifying and reporting on US reportable accounts.

The W-8 forms requested are not filed with the IRS. They are used by the requesting financial institution to enable it to complete its own FATCA due diligence and determine whether an account should be marked as a US reportable account.

The United States has negotiated IGAs with more than 100 countries for the implementation of FATCA. Thus, the requesting financial institution generally applies the due diligence procedures contained in Annex I of an IGA, pursuant to which it may accept as documentation the account holder's self-certification on an IRS Form W-8. In the case of an account holder that is a disregarded entity owned by a single beneficial owner, that documentation is the W-8 for its beneficial owner.

### **Disregarded entity holding investment assets**

International families utilise succession planning structures that include trusts and companies. The typical situation is a non-US company wholly owned by a foreign trust – generally a trustee-documented trust for FATCA purposes (for further details please see "FATCA: trustee-documented trusts are not sponsored entities"). The company holds the investment assets and has various accounts with financial institutions. The non-US settlor is often a beneficiary of the trust and/or can revoke the trust so that at the settlor's death, the company protects the settlor's estate from owing US estate tax on the value of US investments. When requested, the company can provide a FATCA Form W-8BEN-E indicating a Chapter 3 withholding status of 'corporation' and a Chapter 4 FATCA status of 'non-reporting IGA foreign financial institution (FFI)' in the case of a sponsored closely held investment vehicle or sponsored investment entity.

Following the death of the settlor, if the class of discretionary beneficiaries includes US persons the company may make a check-the-box election to be disregarded for US income tax purposes. This election protects US beneficiaries from the passive foreign investment company (PFIC) reporting and taxation rules. Nothing with regard to the structure itself has changed as a result of the election. The company still has financial accounts in its name and holds the investment assets. However, having made a check-the-box election, the way in which the company responds to requests for FATCA documentation will change.

### **Disregarded entity provides W-8 documentation for its owner**

The W-8BEN-E instructions specify that Form W-8BEN-E is not to be used if:

*"You are a disregarded entity with a single owner that is not a US person... and you are not a hybrid entity claiming treaty benefits. Instead, the single owner should provide Form W-8BEN or Form W-8BEN-E (as appropriate)."*

Therefore, when the company is asked by a financial institution to provide a Form W-8 for purposes of documenting an account with that financial institution in the name of the company, the company should provide the requester with a Form W-8BEN-E for the trust, its beneficial owner, entering the name of the trust on Line 1, showing the trust's Chapter 3 status of 'complex trust' and Chapter 4 status of 'non-reporting IGA FFI' as a trustee-documented trust under the relevant IGA. To tie the trust's W-8 to the account in the name of the company, Line 10 of the form can be used to include the name of the company, the disregarded entity, as it appears on the account.

Although Line 3 of the W-8BEN-E says "name of disregarded entity receiving the payment", this line is not to be completed except in specific described circumstances. Likewise, Part II is completed only when the disregarded entity is a branch office of the FFI identified on Line 1 operating in a different jurisdiction with its own IRS registration and global intermediary identification number (GIIN).

### **Disregarded entity provides its own W-8 documentation**

Notwithstanding the foregoing analysis, sometimes a disregarded entity is required to provide its legal name on Form W8:

- The company has registered as a reporting Model 1 or Model 2 FFI with the IRS, has been issued a GIIN and is not claiming treaty benefits. This is when line 3 of the W-8BEN-E is used to enter the name of the disregarded entity itself that holds an account with the foreign financial institution requesting the form. This is spelled out in the instructions on page 7. The name of the single owner still appears on Line 1 and the Chapter 3 and 4 statuses are that of the owner. The owner is a subsidiary of the single owner, not a branch.
- A company that is a hybrid entity claiming treaty benefits will provide on Line 1 its legal name, determined by reference to its legal identity in its country of incorporation. For example, the company which has made a US check-the-box election is subject to tax as a corporation on its worldwide income in a treaty country. In order to claim the treaty benefit and prevent the requester from withholding too much, the company must provide Form W-8BEN-E on its own behalf, showing a Chapter 3 status of 'disregarded entity' and ticking the box that it is making a treaty claim. The instructions to Form W-8BEN-E, page 14, state that the hybrid entity is not to complete line 5, Chapter 4 status. The single owner of the disregarded hybrid entity shall also provide the appropriate Form W-8 to the withholding agent. Use Line 10 to associate the two forms for the requester.

### **Disregarded investment entity need not register with the IRS**

The company will be considered an 'investment entity' for purposes of FATCA if its passive investments are professionally managed. However, a company disregarded for US tax purposes need not register with the IRS to obtain a GIIN and need not arrange for a sponsoring entity. This conclusion takes into consideration the FATCA regulations and IGAs. The company can be registered, but registration is not required.

The FATCA regulations define 'entity' to mean any person other than an individual. Regulation 1.1471-1(b)(94) specifically provides: "The term person does not include a wholly owned entity that is disregarded for federal tax purposes as an entity separate from its owner." One of the stated purposes of the IGAs is to provide for the implementation of FATCA. It could be thought that if the law creating the whole system does not consider a wholly owned, disregarded entity to be a person for purposes of that law, that should be the end of the analysis. But technically under the

IGAs, the term 'entity' is defined differently to mean "a legal person or a legal arrangement such as a trust" and the term 'person' is not defined in the IGA. Any term not otherwise defined in the IGA shall, unless the context otherwise requires or the competent authorities agree to a common meaning, have the meaning that it has under the law of the party applying the IGA. Thus, from the viewpoint of the IGA jurisdiction a 'legal person' can include a company established under its companies act, even though that company has made a US check-the-box election to be disregarded. Even before FATCA this hybrid entity situation had to be dealt with in the treaty context. Some IGA guidance notes – including those of the British Virgin Islands and the Cayman Islands – have said that US entity classification elections (check-the-box elections) made to the IRS are not necessarily conclusive in determining whether an entity is within the scope of the IGA. The draft Irish notes state that it is irrelevant for determining whether an entity is resident in Ireland.

Given that the IGA jurisdiction considers the company to be a legal person, when determining whether the company itself has FATCA registration and reporting obligations under the relevant IGA, there is an argument that it has no such obligations because the company, which is an investment entity, can be classified as a non-reporting financial institution. This is consistent with, for example, the BVI and Cayman guidance notes, which provide that where a trust that is a British Virgin Islands or Cayman Islands financial institution is treated as a non-reporting financial institution, then any underlying related entities may also be treated as non-reporting financial institutions. This is the correct result. Since the equity interests of the underlying company are owned by the FATCA-compliant trust, it can never have a US reportable account under Annex I of the IGA. Any US persons will be reported to the IRS at the trust level. The disregarded company supplies the W-8BEN-E for the trust when requested and so should not need its own sponsoring entity. One possible technical analysis is that under the Model 1 and Model 2 IGAs, a non-reporting financial institution includes an entity that otherwise qualifies as a deemed-compliant FFI under the FATCA regulations. A certified deemed-compliant FFI under the regulations includes an owner-documented FFI. By supplying the requesting financial institution with the documentation for its non-US beneficial owner, the disregarded entity has arguably met the documentation for this status.

## **Comment**

Financial institutions all over the world are struggling to understand and comply with FATCA. Unfortunately the W-8 forms and their instructions are difficult to understand and follow. For the entity providing a FATCA certification, what is most important to remember is that the form is signed under penalties of perjury. Therefore, the individual signing on behalf of the entity must feel comfortable with the information being certified. The W-8 forms are not filed with the IRS; they are provided to assist a requesting financial institution with its due diligence obligations. This may mean that family advisers will need to have a conversation with the family's banker or investment manager. Many financial institutions are not providing assistance to account holders in completing the forms. A knowledgeable US FATCA adviser can smooth the way.

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