
FINN DIXON & HERLING LLP

GETTING READY FOR FATCA: --- ACTION ITEMS FOR OFFSHORE INVESTMENT FUNDS



ATTORNEYS AT LAW

FATCA Overview

- n Enacted as part of the Hiring Incentives to Restore Employment (“HIRE”) Act of 2010 (P.L. 111-147).
- n Compliance initiative to identify U.S. taxpayers using offshore accounts to evade tax.
- n Creates a broad information gathering and reporting regime enforced by punitive withholding taxes.

FATCA Overview

- n Requires that “Foreign Financial Institutions” (“FFIs”) enter into agreements with the IRS (or reciprocal IGA jurisdiction) agreeing to:
 - q Identify and report certain accounts held by U.S. investors.
 - q Withhold on “pass-through payments” to “recalcitrant account holders.”
- n For this purpose, offshore investment funds (e.g. master funds, offshore feeder funds and stand-alone offshore funds) are FFIs.
- n Likewise, a foreign SPV formed by a private equity fund will generally be an FFI.
 - q May not matter if the SPV is not going to generate any income subject to FATCA withholding.

FATCA Overview

- n Non-Compliance with FATCA will result in:
 - q 30% withholding tax on dividends and interest from U.S. sources (including “portfolio interest”).
 - q 30% withholding tax on the gross proceeds of the sale of property giving rise to U.S. source dividends and interest.
- n Domestic funds will be “withholding agents” required to withhold on foreign investors that are not FATCA compliant.
- n Offshore funds that are “non-withholding foreign partnerships” or foreign corporations that are not “qualified intermediaries” will only be required to withhold on “pass-through” payments to “recalcitrant account holders.”
 - q The IRS has reserved on the definition of “pass-through payments”.
 - q Recalcitrant account holders are generally investors who do not provide the information necessary for the due diligence process.
 - q Pass-through withholding does not take effect until 2017.

FATCA Overview--IGAs

- n A foreign jurisdiction may enter into an “intergovernmental agreement” (“IGA”) with the U.S. to provide for FATCA compliance.
- n There are two models of IGA:
 - q Model 1 IGA: Provides for the foreign jurisdiction to collect the necessary information and turn it over to the U.S. Treasury.
 - n Reciprocal and Non-Reciprocal.
 - q Reciprocal IGAs are only available with jurisdictions that have a comprehensive income tax treaty with the U.S..
 - n Current Model 1 IGAs with Denmark, Germany, Ireland, Mexico, Norway, Spain and the UK.
 - n Cayman, BVI, Jersey, Guernsey and Luxembourg (among others) have announced plans to enter into Model 1 IGAs.
 - q Model 2 IGA: Provides for the foreign jurisdiction to permit FFIs to enter into an agreement directly with the U.S. Treasury (notwithstanding the bank secrecy laws of the jurisdiction which might otherwise have prevented compliance).
 - n Current Model 2 IGAs with Switzerland and Japan.
 - n Bermuda has announced plans to enter into a Model 2 IGA.

FATCA Overview—Implementation Timelines

- n FATCA implementation is phased over a three-year period.
- n Notice 2013-43 issued on July 12, 2013 created a new implementation timeline delaying the prior dates by 6 months.

Three Significant Elements of FATCA

- n Registration
- n Due Diligence and Investor Onboarding
- n Governance (Responsible Officer)

FATCA Registration Dates

| August 19, 2013 | April 25, 2014 | June 2, 2014 | July 1, 2014 | January 1, 2017 |
|---------------------------|---|--------------------------------|---|---|
| Registration Portal Opens | Last day to register to be on first FATCA compliance list | FATCA compliance list released | Withholding on dividends and interest begins. | Withholding on gross proceeds and pass-through payments begins. |

FATCA Registration

- n The IRS is creating an online portal to give FFIs the opportunity to either:
 - q Enter into an FFI Agreement or
 - q Register as FATCA compliant under an IGA
- n Data entered into the portal in 2013 will not be treated as “submitted” until January 1, 2014.
- n Beginning on January 1, 2014, the IRS will issue a Global Intermediary Identification Number (“GIIN”) to entities whose registration is approved.
- n The GIIN will be used in certifying FATCA status to withholding agents.

FATCA Registration

- n On June 2, 2014, the IRS will post a list of all FATCA-compliant entities.
- n Registration must occur by April 25, 2014 for an FFI to be included on the list.
- n Registration will be done via online portal or by paper submission of IRS Form 8957.
- n Each entity will have to include its FATCA classification:
 - q Participating FFI not covered by an IGA or a reporting FFI under a Model 2 IGA; or
 - q Model 1 IGA or other Registered Deemed Compliant FFI
- n Form 8957 is signed by the “Responsible Officer.”

FATCA Registration—Status of Registrant

- n Single entity
- n Lead of an Expanded Affiliated Group (“EAG”).
 - q Generally the common parent of the EAG.
- n Member (not lead) of an EAG
- n Sponsoring Entity
 - q Entity that is going to undertake FATCA compliance on behalf of one or more “investment entities” that are FFIs (e.g. offshore funds).

Definition of EAG

n Corporations

- q Generally 1 or more chains of corporations connected through stock ownership with a common parent corporation if—
 - n the common parent owns directly stock possessing more than 50% of the vote and more than 50% of the value of at least 1 of the other corporations, and
 - n stock possessing more than 50% of the vote and more than 50% of the value of each corporation is owned directly by 1 or more of the other corporations.

n Partnerships and other entities

- q A partnership is included in the expanded affiliated group if more than 50% of the value of the entity is owned by members of the expanded affiliated group.

Sponsoring Entity

- n In order to qualify as a “sponsoring entity” an entity must:
 - q Be authorized to manage the FFI and enter into contracts on behalf of the FFI (such as a fund manager, trustee, corporate director, or managing partner);
 - q Register the FFI with the IRS;
 - q Agree to perform, on behalf of the FFI, all due diligence, withholding, reporting, and other requirements that the FFI would have been required to perform if it were a participating FFI; and
 - q Identify the FFI in all reporting completed on the FFI's behalf.

Registration Action Items

- n Designate responsible officer.
- n Identify the EAG.
- n Determine whether to use a U.S. or offshore entity to act as a “sponsor.”
- n Keep abreast of IGA developments.

Due Diligence and Investor Onboarding

- n FATCA requires that participating FFIs (e.g. offshore funds) implement:
 - q New investor onboarding procedures; and
 - q New due diligence procedures with respect to “pre-existing accounts”.

Due Diligence Process

- n Goal: To identify “specified U.S. persons” (generally taxable entities other than publicly traded corporations and their affiliates)
- n Diligence Procedures:
 - q Documentation
 - q Validation
 - q Record Retention and Monitoring Changes in Circumstances

Documentation of Investors: Initial Identification

- n Valid form W-9/W-8.
- n Application of presumption rules.
- n Other documentary evidence establishing the status of the person.
- n Self-certification for IGA jurisdiction financial institutions.
- n Pre-FATCA forms W-8 may be used to establish a person's status as a foreign individual, foreign government or international organization. Pre-FATCA form W-8 may be used to document other investors until January 1, 2017 if there is also other documentary evidence:
 - q Organizational documents (e.g. articles of incorporation)
 - q Financial statements
 - q Third-party credit report
 - q Letter from a governmental agency

Reliable Association: Validating the Documentation

- n Documentation can be relied upon so long as the FFI/withholding agent does not know, or have reason to know, that the documentation is incorrect.
- n This requires validation of the withholding certificates.
 - q Cross-check against all other documentation collected in connection with opening the account (including customer files, AML due diligence, etc...) and other documentation in the customer master-file.
 - q If, with respect to a purported foreign investor, there is any “U.S. indicia” (e.g. United States address, place of birth, telephone number, power of attorney holder, etc...), then additional documentation may be required to “cure” the U.S. indicia.

Preexisting Accounts

- n For pre-existing individual accounts, verification only requires a review of electronically searchable information associated with an account (except in the case of “high value accounts”).
 - q For individual accounts with a balance in excess of \$1,000,000 (“high value accounts”), there is enhanced review that includes:
 - n Inquiry as to knowledge of relationship manager
 - n Review of customer master-file.
 - q Not required if electronically searchable information includes all possible U.S. indicia (e.g. address, telephone number, nationality, etc...)
- n No electronic search is needed for individual accounts with a balance under \$50,000 or for entity accounts with a balance under \$250,000 (if no U.S. person has been previously associated with the account).

Key Due Diligence Dates (Likely to be modified under IGAs)

| Account | Implementation of due diligence procedures | Completion of Due Diligence |
|--------------------------------|--|--|
| New Account | July 1, 2014 | Earlier of 90 days after investment or first withholdable payment. |
| Preexisting Individual Account | | <u>High Value Account:</u> June 30, 2015 <u>Non High Value Account:</u> June 30, 2016 |
| Preexisting Entity Account | | <u>Prima Facie FFI*:</u> December 31, 2014 <u>Other Entities:</u> June 30, 2016 |

*Prima Facie FFI: the entity is entity is a “qualified intermediary” or has a North American Industry Classification System or Standard Industrial Classification System code indicating that it is a financial institution.

Due Diligence—Action Items

- n Compiling necessary searchable electronic databases.
- n Update subscription documents to include the delivery of necessary forms to document and validate Chapter 4 status.
- n Consider refresh of all existing W-8s and W-9s.
- n Create infrastructure of validation of W-8/W-9 forms against subscription documents.
- n Begin remediation process for any existing offshore investors with U.S. indicia.

Governance--the Responsible Officer

- n The final FATCA regulations require that a participating or registered deemed compliant FFI appoint a “responsible officer” to oversee, and certify as to, the organization’s compliance with its obligations under FATCA.
- n A “responsible officer” is any “officer of any participating FFI or reporting Model 1 FFI in the participating FFI's expanded affiliated group with sufficient authority to fulfill the duties of a responsible officer.” (Treas. Reg. §1.1471-1(b)(108)).

Responsibilities of the Responsible Officer

- n Compliance Program
- n Certifications

Compliance Program

- n The responsible officer must oversee a compliance program.
 - q Responsibility for design and oversight of the compliance program can be delegated.
 - q Compliance program must include policies, procedures and processes sufficient for the FFI to satisfy the requirements of its FFI Agreement.
- n The responsible officer (or its designee) must periodically review the sufficiency of the compliance program.
 - q A participating FFI that is part of an expanded affiliated group can enter into a consolidated compliance program with other members of its expanded affiliated group. In that case, one of the members of the compliance group (or a sponsoring entity) can assume responsibility for maintenance and periodic review of the compliance program for all of the entities in the compliance group.

Certifications of the Responsible Officer

- n The responsible officer must certify as to both:
 - q The FFI's compliance program (every three years); and
 - q The FFI's due diligence procedures (no later than 60 days following the two-year anniversary of the effective date of the FFI Agreement).
- n The certification must come from the responsible officer and not a designee.

Compliance Program Certification

- n The responsible officer (or a designee) has established a compliance program that is in effect and has been subject to periodic review.
- n Either:
 - q There are no material failures for the certification period; or
 - q If there are any material failures, appropriate actions were taken to remediate such failures and to prevent such failures from reoccurring.
- n With respect to any failure to withhold, deposit or report to the extent required under the FFI Agreement, the FFI has corrected such failure by paying any taxes due (including interest and penalties) and filing the appropriate return.

Due Diligence Certification

- n The FFI has completed the review of all high-value accounts and treats any account holder for which the FFI does not have the required documentation as a recalcitrant account holder;
- n The FFI has completed the required account identification procedures for all other preexisting accounts; and
- n To the best of the responsible officer's knowledge after conducting a reasonable inquiry, the participating FFI did not have any formal or informal practices or procedures in effect from August 6, 2011 through the date of certification to assist account holders in the avoidance of Chapter 4.

Anti-Avoidance Certification

n Reasonable Inquiry

- q Review of the FFI's procedures and a written inquiry to the relevant lines of business that requires responses from customer onboarding and management personnel as to whether they engaged in "avoidance practices."

n Avoidance Practices

- q Suggesting that account holders split up accounts to avoid classification a high-value account;
- q Suggesting that holders of U.S. accounts close, transfer or withdraw the account to avoid reporting;
- q Intentional failures to disclose a known U.S. account;
- q Suggesting that an account holder remove U.S. indicia from its account information; or
- q Facilitating the manipulation of account balances or values to avoid thresholds.

Qualified Certifications

- n If the responsible officer is unable to make a required certification (because it isn't true), the responsible officer can provide a "qualified certification."
- n A qualified certification states that the certification cannot be made and that corrective actions will be taken by the responsible officer.

Model 1 IGA Implications

- n The Model 1 IGA does not require certifications by a responsible officer.
- n Query whether Model 1 IGA jurisdictions are likely to implement similar responsible officer certification requirements for FFIs reporting information to such jurisdictions.

Governance Structure-Action Items

- n **Appoint a Responsible Officer**
 - q Someone sufficiently high-level to have access to the necessary business units.
 - q Someone who has been trained in the due diligence procedures required by FATCA.
- n **Develop a compliance framework**
 - q Train investor relations personnel in anti-avoidance requirements and due diligence obligations.
 - q Create processes for detection and remediation of due diligence failures (and other events of default under the entity's FFI Agreement).
 - q Determine the extent of compliance outsourcing
- n **Develop a Sub-Certification Process**
 - q Relevant business units and third-party service providers will have to provide the responsible officer with reliance certifications as to compliance and anti-avoidance.

Questions?

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