

CLIENT ALERT

Top 5 Things Investment Funds Need to Know about FATCA by June 3

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The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, will apply to investment funds and other "financial institutions" starting on July 1, 2014. Funds that are required to comply but do not may soon be subject to 30 percent withholding on payments they receive, which will reduce the investment return available to LPs.

As a general matter, funds need to determine whether FATCA applies to the fund and what the compliance obligations are. In many cases, FATCA will apply to foreign entities in the fund structure, which generally should register with the IRS by June 3 in order to be on the IRS list of compliant entities by July 1. In order to comply with FATCA on an ongoing basis, funds will need to collect adequate documentation from investors and should update their LP agreements and subscription documents accordingly. FATCA is extremely complicated, with thousands of pages of regulations and various intergovernmental agreements. In light of the potential economic consequences of noncompliance (withholding of 30 percent on certain payments made to the fund or its affiliates), funds with foreign operations should consult their regular counsel to determine their compliance responsibilities.

1. Does FATCA apply to my fund?

Very generally, FATCA requires a payor of certain "U.S.-source" payments (such as interest on U.S. obligations and dividends from U.S. companies) to certain types of foreign entities to withhold 30 percent of these payments. Withholding does not apply if the foreign entity is exempt from or complies with FATCA's reporting obligations. Accordingly, FATCA may require withholding on payments to entities in the fund structure that are established in foreign jurisdictions.

FATCA applies to "foreign financial institutions," or FFIs, which include investment funds, including private equity, hedge, and venture capital funds. Most FFIs need to register with the IRS and annually report certain information to the IRS or the foreign jurisdiction of incorporation. The reporting obligations will depend on whether the foreign country of organization has a FATCA agreement with the United States, and what type of agreement it is ("model 1" or "model 2"). A few limited categories of FFIs are exempt from these registration and reporting requirements.

Thus, FATCA registration requirements will likely apply to foreign entities—including feeder funds and alternative investment vehicles (AIVs)—in the fund structure. In order to avoid the 30 percent withholding on U.S.-source payments that will begin on July 1, funds need to determine whether any of their foreign entities are FFIs and whether they need to register with the IRS.

2. When is the registration deadline?

The registration deadline for FFIs that are organized or have branches outside of "model 1" countries is June 3, 2014, to be on the IRS list of compliant entities in time for the July 1 effective date of FATCA. Entities that are not on the IRS's list of compliant entities may be subject to 30 percent FATCA withholding starting on July 1.

FFIs organized in "model 1" countries and that do not have branches in non-"model 1" countries will not need to provide documentation of FATCA registration to payors until January 1, 2015. They therefore have until December 22, 2014, to register with the IRS to ensure that they are included on the IRS list of compliant entities by January 1, 2015. It may be prudent, however, to register in advance of this deadline for reputational purposes and to streamline the process of providing documentation to withholding agents.

As of April 18, 2014, "model 1" countries for this purpose include Australia, Belgium, Brazil, British Virgin Islands, Canada, Cayman Islands, Costa Rica, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Gibraltar, Guernsey, Honduras, Hungary, Ireland, India, Isle of Man, Italy, Jamaica, Jersey, Kosovo, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mauritius, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Qatar, Romania, Slovak Republic, Slovenia, South Africa, South Korea, Spain, and the United Kingdom.

3. What happens after the entity registers?

The registering FFI will have annual reporting obligations to the IRS or the country of organization. The exact reporting obligations will depend on whether the foreign country has a FATCA agreement with the IRS, and whether it is a "model 1" or "model 2" agreement. An FFI in a "model 1" country will be required to report certain information to the country of organization, while an FFI in a "model 2" country will be required to report information to the IRS. Generally, the FFI will be required to report information about its LPs, including the name, address, and taxpayer identification number of each account holder, and the value of the account.

4. What if the entity is required to register but doesn't?

An FFI that fails to register with the IRS and is not exempt from registration will be subject to FATCA withholding of 30 percent on U.S.-source payments. Payors of these types of payments will request an IRS Form W-8BEN-E from the FFI. The IRS released the Form W-8BEN-E in March 2014, and has updated it to include information about the payee's FATCA status. FATCA withholding from non-compliant FFIs is not a credit against tax and cannot be refunded by the IRS. Thus, it will reduce the return for the fund's investors.

5. What does the fund need from its investors?

Every investment fund needs to collect the right documentation from its investors. LP agreements should be updated to require limited partners to provide information to comply with FATCA, and subscription agreements similarly should request IRS Forms W-9 or W-8 (as applicable) from every investor. Failure to obtain this information from investors will make it impossible for the fund to comply with FATCA.

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